P.A.C. No. 423

PUBLIC ACCOUNTS COMMITTEE (1973-74)

(FIFTH LOK SABHA)

HUNDRED TWENTY EIGHTH REPORT

[Chapter II of the Report of the Comptroller and Auditor General of India for the year 1971-72, Union Government (Civil), Revenue Receipts, Volume II, Direct Taxes, relating to Corporation tax.]

LOK SABHA SECRETARIAT
NEW DELHI

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INTRODUCTION

I, the Chairman of the Public Accounts Committee as authorised by the Committee do present on their behalf this Hundred and Twenty-Eighth Report of the Committee (Fifth Lok Sabha) on Chapter II of the Report of the Comptroller and Auditor General of India for the year 1971-72. Union Government (Civil), Revenue Receipts, Volume II Direct Taxes—relating to Corporation Tax.

2. The Report of the Comptroller and Auditor General of India for the year 1971-72, Union Government (Civil), Revenue Receipts, Volume II, Direct Taxes was laid on the Table of the House on the 25th April, 1973. The Committee examined the paragraphs relating to Corporation Tax at sitting held on the 23rd November, 1973(AN). This Report was considered and finalised by the Committee at their sittings held on the 18th and 19th April 1974(AN). Minutes of the sittings form Part II* of the Report.

3. A statement showing the summary of the main conclusions/ recommendations of the Committee is appended to the Report. For facility of reference, these have been printed in thick type in the body of the Report.

4. The Committee place on record their appreciation of the assistance rendered to them in the examination of these paragraphs by the Comptroller and Auditor General of India.

5. The Committee would also like to express their thanks to the Officers of the Ministry of Finance for the cooperation extended by them in giving information to the Committee.

NEW DELHI;
19th April, 1974.
29th Chaitra, 1896 (S).

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JYOTIRMOY BOSU,
Chairman,
Public Accounts Committee.

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CHAPTER I

INCORRECT COMPUTATION OF CORPORATION TAX

Audit Paragraph

1.1. Under the Finance Act, 1968 certain categories of domestic companies were liable to pay tax at 7.5 per cent on that part of dividends distributed during the relevant previous year, which exceeded 10 per cent of the paid-up equity share capital of the company as on the first day of the previous year. In the following two instances there was a failure to levy this tax correctly.

(a) A company, falling in one of such categories, which had a paid-up equity share capital of Rs. 5,02,000 as on the first day of the previous year relevant to the assessment year 1968-69 distributed equity dividend totalling Rs. 28,11,200. The dividends distributed in excess of 10 per cent of the equity share Capital this amounted to Rs. 27,61,000 on which the additional tax leviable worked out to Rs. 2,07,075. But the department computed the excess dividends at Rs. 17,97,200 and levied an additional tax of Rs. 1,34,790 resulting in under-assessment of tax of Rs. 72,285.

(b) In the case of another company it was liable to pay the excess dividend tax at Rs. 1,12,500 for the assessment year 1968-69. But the department did not levy it. There was, thus, an undercharge of tax to the extent of Rs. 1,12,500 in respect of the assessment year 1968-69. In the same case, for the assessment year 1967-68 while an amount of Rs. 50,000 only was leviable, the department levied the tax at Rs. 1,12,500.

1.2. The Ministry have replied that the omissions in the assessments of the two companies mentioned above for the assessment year 1968-69 have been rectified raising additional demands of Rs. 72,285 and Rs. 1,12,500 respectively.

[Paragraph 16(i) of the Report of the Comptroller and Auditor General of India for the year 1971-72, Union Government (Civil), Revenue Receipts, Volume II-Direct Taxes].

1.3. Omissions of the type mentioned in the Audit paragraph were noticed in test audit in previous years also as can be seen from the following figures:

Audit Report	Para No.	No. of cases	Tax under-charged
1969 . . .	56(d)	7	Rs. 2,86,801
1970 . . .	54(b)	6	Rs. 2,18,530
1969-70 (1971)	40(c)	5	Rs. 5,55,152
1970-71	50(c)	8	Rs. 10,17,393

1.4. The Committee enquired whether the Ministry had thought of a general review of the assessments of companies for the assessment years 1964-65 to 1968-69. The Ministry of Finance (Department of Revenue and Insurance) in a note submitted to the Committee, stated: "The Ministry have ordered a review of the assessments of the companies for the assessment years 1964-65 to 1968-69. We have received reports of the review from most of the Commissioners and a few others are still awaited. Reports received so far indicate that the mistake of this nature has been noticed in 15 cases. Necessary follow-up action is being taken up."

1.5. When asked how the additional tax in the case at para (b) was omitted to be levied, the Ministry, in a note, stated: "In the previous year relevant to the assessment year 1968-69 the assessee company declared and distributed equity dividend of Rs. 40 lakhs. Its paid-up equity capital at the beginning of the previous year was Rs. 50,00,000. There was thus an excess distribution of Rs. 15,00,000 on which the company was liable to pay additional tax at 7.5 per cent amounting to Rs. 1,12,500. The ITO who completed the assessment was of the view that the tax had already been charged in the assessment year 1967-68 in respect of this dividend which was proposed in the earlier year. Therefore, he was under the impression that it was not to be charged in the assessment year 1968-69."

1.6. The Committee learnt from Audit that the recovery of tax was stated to have been made by adjustment. The Committee wanted to know the particulars of that adjustment. The Ministry, in a note, stated: "The entire additional tax as a result of the Audit objection has been adjusted against refund which became due to the assessee on completion of assessment relating to the assessment year 1970-71. The refund had arisen as a result of excess advance

tax paid by the assessee in respect of the assessment year 1970-71 which assessment was completed on 29-3-1971 and which became due to the assessee on that date."

1.7. The omission levy additional tax at the rate of 7.5 per cent on equity dividend declared or distributed by the companies for the assessment year 1968-69 in the two cases mentioned in the Audit paragraph resulted in short-levy of tax amounting to Rs. 1.85 lakhs. This looks to be a 'tip of an iceberg'. Year after year a number of such cases have been brought to the notice of the Committee through Audit Reports. The Audit Report, 1970-71, mentioned 8 such cases involving under-assessment to the extent of Rs. 10.17 lakhs. The Committee take a very serious view of repetitive failures of this kind in the Company Circles particularly as they are manned by senior and experienced officers. The Committee are of the view that disciplinary action is called for against officers including the supervisory officers who are found to have been neglected in the discharge of their duties.

1.8. The Committee learn that the Ministry have ordered a review of the assessment of the companies for the assessment years 1964-65 to 1968-69 and that the results so far available indicate omissions to levy additional tax in 15 cases. It would have been more satisfactory had this review been conducted by the IAC (Audit). The Committee await the final outcome of the review which they trust would be followed up immediately by action to recover additional tax due in respect of under-assessments that are detected.

Audit Paragraph

1.9. Under the Finance Act, 1964, a company which was mainly engaged in the manufacture of processing of goods, was eligible for a rebate in super-tax at the rate of 30 per cent; in other cases the rebate admissible was 20 per cent.

A company which was not a manufacturing company in which public were not substantially interested, was erroneously allowed super-tax rebate at the rate of 30 per cent on its total income of Rs. 1,66,028 (mainly consisting of commission receipts) for the assessment year 1964-65 instead of at the correct rate of 20 per cent, resulting in short-levy of tax of Rs. 16,603.

1.10. The Ministry have replied in November, 1972 that the Internal Audit Party pointed out this mistake on 17-12-1970 but the

rectificatory action had not been completed when the Revenue Audit checked the case on 27-11-1971.

[Paragraph 16(ii) of the Report of the Comptroller and Auditor General of India for the year 1971-72, Union Government (Civil), Revenue Receipts, Volume II—Direct Taxes].

1.11. The Committee were given to understand by Audit that the mistake had been accepted by the Ministry in principle, but they contended that the objection was already detected by the Internal Audit Party. But the actual position was as follows: The Audit objection was raised on the mistake found in the rectificatory assessment dated the 18th January 1971 giving effect to the Appellate Assistant Commissioner's orders. This later assessment had not been seen by the Internal Audit Party. But in the original assessment order dated 9-10-1968 also the Income-tax Officer had committed the same mistake which was pointed out by the Internal Audit Party as early as 17-12-1970. This could have been kept in view by the Income-tax Officer while passing the order dated 18-1-1971. But the mistake was repeated and it was rectified only after it was pointed out by Revenue Audit. The Department was not prompt to rectify a mistake pointed out by its Internal Audit. Not only this, the Income-tax Officer repeated the mistake subsequently also. The Department of Revenue and Insurance in a note furnished to the Committee, stated: "The mistake was pointed out by the IAP on 17th December, 1970. No action was taken on the objection. Rectificatory action was not started till 27-11-1971 when the case was taken up by the Revenue Audit for inspection. It has been explained that immediately after the receipt of IAP's objection the ITO was busy in the scrutiny of appellate order received for the assessment year 1964-65 for the purposes of recommending a second appeal to the I.T.A.T. Besides, jurisdiction over the case was transferred from the Bombay Central charge to the ITO Company Circle III(7) with effect from 7-2-1971. The records were accordingly transferred in March, 1971. Audit objection was not shown in the transfer memo, although the relevant audit folder was included in the records. Thereafter there were frequent changes in the jurisdiction over the case as below:

1-4-71 to 30-5-71		Shri.....(A)
31-5-71 to 22-6-71	.....	Shri..... (B)
23-6-71 to 4-7-71	.....	Shri ..... (C)
5-7-71 to 17-7-71	.....	Shri .....(B)
18-7-71 to 27-11-71	.....	Shri .....(A)"

1.12. Pointing out that it was understood that the Board had issued a circular explaining the various provisions of the Finance Act, the Committee asked for the circumstances in which such a mistake had occurred especially in a Central Circle. They also wanted to know the total number of assessments made during 1970-71. The Ministry, in a note, stated: "In this case the mistake occurred in the original assessment made on 9-10-1968 and was repeated while giving effect to the AAC's order on 18-1-1971. The explanation of the ITO who committed the mistake in the original assessment is still awaited (The officer concerned is on deputation and hence the delay). The officer who repeated the mistake while giving effect to the AAC's order has stated that it is debatable whether the mistake could be rectified while giving appeal effect. This explanation has, however, been not accepted. The total number of assessments completed during the year by the ITO (Shri....'A') was 54 I.T., 17 W.T. and 1 G.T. In addition to this, this officer was completely in charge of recovery work of all Central Circles under IAC (Central)."

1.13. The Committee wanted to know the date on which this case was assigned to the Central Circle and the basis for which it was assigned. They also desired to know the criteria adopted for assigning cases to Central Circle and the intervals in which the cases assigned to Central Circle would be reviewed to find out whether they were fit enough to be included in the Central Circle. The Ministry, in a note, stated: "The case was assigned to Central Circle in March 1960, as there was suspected tax evasion in this group of cases. The cases are assigned to Central Circle normally when the Department considers that there is need for closer scrutiny from the point of tax evasion/avoidance. In certain cases, the whole group consisting of the main case and connected cases are assigned to Central Circle. There is no specified time—limit for retention of cases in the Central Circle. When once the Commissioner (Central) considers that there is no scope or need for further investigation, he sends proposal to the Board for re-transfer of cases to the regular Circles. The Board, depending upon the facts and circumstances of each case, passes necessary orders."

1.14. The Committee learnt from Audit that the rectificatory action could not be done as the Income-tax Appellate Tribunal had set aside the original assessment by its order dated 1-7-1972 for being made afresh. The Committee enquired whether the fresh assessment had been completed. The Ministry, in a note, stated: "Assessment has been made afresh on 26-6-1973 and the objection has been kept in view while framing the fresh assessment."

1.15. In this case, rebate of super-tax was allowed at the rate of 30 per cent instead of 20 per cent admissible under the Finance Act 1964, in the original assessment made on 9th October, 1968. Strangely enough the mistake was repeated while giving effect to an appellate order on 18th January 1971. When a mistake of this kind is repeated in a case which was specifically assigned to the Central Circle owing to suspected tax evasion it cannot but cause concern and arouse suspicion in the mind of the Committee. A proper inquiry should, therefore, be carried out and appropriate action taken against officers found to be responsible.

1.16. The Internal Audit had pointed out the mistake in this case on 17th December, 1970 and had there been the intention it could have been easily rectified while giving effect to the appellate order on 18th January 1971. Regrettably no action was taken to rectify the mistake till 27th November 1971 when the case was taken up by the Revenue Audit. The Committee had taken note of the very unsatisfactory position in regard to rectification of mistakes pointed out by Internal Audit Parties in paragraph 2.27 of their 51st Report (Fifth Lok Sabha). The explanation given by the Ministry for the delay in taking action to rectify the mistake pointed out by the Internal Audit in this case brings out another unsatisfactory feature of the working of the Department. There have been as many as five changes of ITOs in relation to this case during a period of less than 8 months (1-4-71 to 27-11-71). Such frequent changes are obviously undersirable; as they cannot but result in inefficiency, they should be avoided in future. In this connection the Committee would recall their observation contained in para 2.331 of their 51st Report.

Audit Paragraph

1.17. Under the provisions of the Income-tax Act, 1961 certain categories of income were allowed rebate of tax at the average rate of tax applicable to the total income. In the case of a company for the assessment year 1965-66 the department took into account only the tax levied on the income other than long-term capital gains of the assessee for arriving at the average rate. Since the long-term capital gains are eligible for a concessional rate of tax, the average rate arrived at by the department was higher than the correct rate and as a result, the rebate allowed by the department at the average rate was in excess of the rebate correctly admissible. This mistake in the computation of the average rate of tax resulted in excess allowance of rebate of tax of **Rs. 30,305.**

1.18. The Ministry have replied (November, 1972) that the mistake has been rectified. Report of recovery is awaited.

[Paragraph 16(v) of the Report of the Comptroller & Auditor General of India for the year 1971-72, Union Government (Civil), Revenue Receipts, Volume II—Direct Taxes].

1.19. Under Section 85-A of the Income-tax Act 1961, inter-corporate dividends received by an Indian company are eligible for a deduction from income-tax at the average rate of income-tax on the income so included as exceeds an amount of 25 per cent thereof.

1.20. The average rate of tax is defined under Section 2(10) of the Income-tax Act, as 'the rate arrived at by dividing the amount of income-tax calculated on the total income, by such total income'.

1.21. In the case under discussion, for the assessment year 1965-66, the total income of the company was assessed at Rs. 2,21,29,146 which was inclusive of long term capital gains of Rs. 13,14,961. The assessing officer incorrectly worked out the average rate of tax of 49.7 per cent, ignoring the tax leviable on the long term capital gains. The correct average rate of tax works at 48.65 per cent since capital gains is also a part of the total income. By adopting the incorrect average of tax, the assessee company was allowed excess rebate of Rs. 30,305 resulting in short-assessment of tax of Rs. 30,305.

1.22. The Committee learnt from Audit that the objection had been accepted by the Ministry and that the additional amount of tax of Rs. 33,767 has since been collected by adjustment. The Committee wanted to know how this had happened in this case. The Department of Revenue and Insurance in a note submitted to the Committee, stated: "Rectification was carried out on 23-2-1973. The demand raised was Rs. 33,767. The assessment for the year 1970-71 was completed about the same time, viz. 27-2-1973, which resulted in a refund. The entire demand was adjusted against this refund."

1.23. The Committee desired to know the definition of total income in the Income-tax Act. They also enquired whether it included the capital gains. The Ministry, in a note, stated: "According to Section 2(45), 'total income' means the total amount of income computed in the manner laid down in the Act. As per Section 2(24)(vi), income includes any capital gains chargeable under Section 45. Thus capital gains is includible in the total income."

1.24. The Ministry added: "Under Section 2(10) 'average rate of income-tax' means the rate arrived at by dividing the amount of

income-tax calculated on the total income, by such income. In working out the average rate, the ITO did not take into account the capital gains of Rs. 13,14,961 and tax thereon at Rs. 3,94,488. Since capital gains was taxable at 30 per cent and the other income at 50 per cent, on business income and 45 per cent on income from priority industry, the rate worked out by the ITO was higher viz. 49.7 per cent as against the correct average rate calculated by Audit at 48.65 per cent."

1.25. The Committee enquired whether the tax calculations were not made by a clerk, checked by the head-clerk and then checked by the Income-tax Officer and whether this Income-tax Officer was of the view that for the purpose of working out average rate of tax, capital gains and tax thereon were to be ignored. The Committee also asked whether the Board had thought it fit to order a review of all such cases in this charge. The Ministry, in a note, stated: "Under the existing instructions, all tax calculations of demand and refund are made by one clerk and checked by another. In cases of incomes over Rs. 10,000 or refunds of over Rs. 1,000 either the head-clerk or the supervisor should check and initial the I.T.N.S. 150 form. The ITO's responsibility does not cease at that. He must satisfy himself that the calculations are properly made. He is, therefore, required to personally recheck demands in cases with income over Rs. 1 lakh and refunds over Rs. 10,000. The CIT concerned has been asked to have a selective review conducted with a view to finding out if similar mistakes have been committed."

1.26. The Committee wanted to know the explanation furnished by the Income-tax Officer in this case. The Ministry, in a note, stated: "The ITO has explained that the error in the matter of calculation of average rate is arithmetical and has attributed it to the Calculation Cell. According to him the IAC had given an assurance that the ITOs will not be held responsible for any mistakes in the calculation of taxes. This explanation has not been accepted and the Additional CIT has observed that it was the ITO's duty to check tax calculations as per clear instructions of the Board."

1.27. The Committee enquired whether this case was checked by the Internal Audit Party; if so, they asked for the circumstances in which the same mistake which was committed by the ITO escaped their notice. The Ministry, in a note, stated: "The case was checked by IAP but the mistake was not detected. The U.D.C. concerned has explained that the mistake was due to oversight and he has regretted. He has been warned. The CIT has been asked to place a copy of the warning in his C. C. Roll and shift him from Audit if not found upto the mark."

1.28. Although 'income' as defined under Section 2(24) includes capital gains chargeable under Section 45, in this case mysteriously enough capital gains were omitted while calculating the average rate of tax on total income, for the purpose of allowing rebate on inter-corporate dividends for the assessment year 1965-66. It creates suspicion that despite clear instructions from the Board that the ITO should personally recheck tax calculations of demands in cases with income over Rs. 1 lakh, no check had been carried out in this case which involved a total income of as high as Rs. 221 lakhs. In his explanation for the failure to carry out the checking, the ITO has stated that the IAC had given an assurance that the ITOs would not be held responsible for any mistake in the calculation of tax. Although the explanation has not been accepted, the Committee consider it desirable to ascertain whether any assurance of this nature had been given by the IAC concerned and if so why he had done so. The Committee should be informed of the result of such an inquiry.

1.29. The Committee find that the CIT has been asked to carry out a selective review with a view to finding out if similar mistakes have been committed. They stress that this review should also be extended to seeing whether the ITOs in this charge have been rechecking the tax calculations as per the Board's instructions. The review should be conducted by the IAC (Audit). The Committee would await the results of the review.

Audit Paragraph

1.30. According to the provisions of Finance Acts, 1964 and 1965, a public limited company was entitled to super-tax rebate of Rs. 81,048 in the assessment year 1964-65 which was to be reduced by Rs. 2,14,021 on account of issue of bonus shares and declaration of dividend by the company. As the amount to be deducted exceeded the rebate, deduction was to be limited to the extent of the rebate so as to make it nil and the balance amount was to be carried forward for deduction from the income-tax rebate admissible to the company in the subsequent assessment year 1965-66. While the deduction of Rs. 81,048 was correctly made in assessment year 1964-65 the balance of Rs. 1,32,973 was not carried forward for deduction from income-tax rebate in assessment year 1965-66. This resulted in short charge of tax of Rs. 1,32,973 in the assessment year 1965-66.

1.31. The Ministry have replied (November, 1972) that the mistake has been rectified. Report of recovery is awaited.

[Paragraph 16(vi) of the Report of the Comptroller and Auditor General of India for the year 1971-72, Union Government (Civil), Revenue Receipts, Volume II—Direct Taxes].

1.32. The Committee were given to understand by Audit that the additional demand raised had since been collected.

1.33. The Committee wanted to know the circumstances in which the mistake had occurred. The Member, Central Board of Direct Taxes stated: "In this case, the Income-tax Officer did not have before him the folder for the preceding year where the carry forward of the rebate which was to be withdrawn, had been recorded in the income-tax assessment year 1964-65. There was also no note on this point. The 1964-65 folder was with the Appellate Assistant Commissioner. It was not before the Income-tax Officer. That is why, he came to make this mistake."

1.34. The Committee learnt from Audit that the assessment (for assessment year 1965-66) was completed on 18-2-1970 i.e., at the end of four year period prescribed for completion of assessments under Section 153 of the Income-tax Act, 1961.

1.35. Drawing attention to their recommendation contained in paragraph 1.33 of their 117th Report (1969-70) that in re-ordering the assessment work, it was important to ensure high income cases were taken up for assessment sufficiently in time during the course of the year, the Committee enquired how it was that the assessment in this case, which was one of the high income groups, was completed in February, 1970. The Committee also wanted to know the income which was assessed. The Ministry of Finance (Department of Revenue and Insurance), in a written note furnished to the Committee, stated: "The original return was filed on 16-7-1965 showing an income of Rs. 8,73,009. A revised return was filed on 16-12-1969 showing an income of Rs. 8,43,009. The income originally returned by the assessee was reduced by Rs. 30,000 on account of an increased bonus claim. The turnover of the company was of the order of Rs. 3.16 crores. The Income-tax Officer had to examine voluminous accounts and statement. This took time and the assessment was completed on 18-2-1970.

The income was assessed at Rs. 18,92,911."

1.36. When asked for the procedural arrangements that had been made to ensure that mistakes in computation of super-tax payable by companies, did not occur in future, the witness deposed: "As far as this particular type of mistake is concerned, the withdrawal of super-tax rebate is not likely to arise. The provision was that if a company declared dividends in excess of certain percentages, the super-tax rebate which was admissible to the company was to be withdrawn. But as far as the general question is concerned, we may tell the Income-tax Officers to obtain the previous year's records before completing the assement."

1.37. Similar provisions (that is, reduction in the rebate of super-tax payable by companies) were there in the Finance Act, 1956 to 1959. And in the Audit Report 1964—1968 and for 1969-70, Audit had reported widespread lapses on the part of the assessing officers in connection with the computation of super-tax payable by companies. In para 11 of their 28th Report (1964-65) the Committee have recommended as follows:

"In view of the fact that lapses in computing super-tax payable by companies are on the increase, the Committee would suggest that a general review may be undertaken and suitable instructions issued to the Assessing Officers."

1.38. Again in para 3.112 of their 73rd Report (1968-69) the Committee have recommended thus:—

> "The Committee note that mistakes in computation of super-tax payable by companies have been occurring year after year. In para 11 of their 28th Report (Fourth Lok Sabha) the Committee had drawn attention to this situation. The Committee note that pursuant to these observation a review of cases of all companies having an income of Rs. 1 lakh or more has been undertaken. Such a review should cover assessments from 1956-57 onwards as the Additional Super-tax by way of reduction of the rebate from super-tax admissible to the companies was levied in the Finance Acts 1956 to 1959. The Committee would like to be informed of the outcome of the review when finalised. They trust that effective action will be taken by Government to ensure that cases of this nature, do not recur."

1.39. In para 2.247 of their 51st Report (Fifth Lok Sabha) the Committee have reminded the Ministry of the above recommen-

dation. The Ministry in their report (dated April, 1973) have stated that as a result of the company assessment cases (completed during the period 1964-65 to 1967-68), under-assessment of tax to the tune of Rs. 6.96 lakhs has been noticed out of which Rs. 5.86 lakhs are to be treated as a loss of revenue as the cases are outside time limit for rectificatory action.

1.40. According to Audit, if the Income-tax Department had conducted the review sufficiently earlier as originally recommended by the Committee, the Government would not have put into the above loss.

1.41. The Committee wanted to know the date on which the review was ordered by the Department. The witness stated: "Originally the review was ordered in 1969."

1.42. The Committee desired to know the reasons for the inordinate delay in ordering the review in 1969 when it was recommended by the Committee in 1964-65 that a general review should be undertaken in view of the wide-spread lapses on the part of the assessing officers in computing the super-tax payable by the companies. The witness stated: "On that point I will check up and see whether we had at all ordered a review at an earlier date and if we did not, why the delay has taken place between 1965 and 1969."

1.434. The Ministry, in a written note, stated: "In the above-noted case, one of the issues involved was Excess Dividends Tax (as levied by Finance Act, 1964). During discussion, reference came up regarding the predecessor scheme in vogue from assessment years 1956-57 to 1959-60, as detailed in following paragraph.

In para 47(a) of the Audit Report (Civil) on Revenue Receipts, 1964 the Audit pointed out a case of incorrect computation of super-tax payable by companies. The mistake related to reduction (and set off/carry forward of such reduction) from rebate on super-tax where a company declared dividends in excess of 6 per cent of its paid up capital vide Finance Acts, 1956 to 1959, whereafter the provision was discontinued. The provision operated for assessment years 1956-57 to 1959-60 though carry forward effect extended to subsequent assessment years. The case mentioned in the above-noted Audit para was commented upon in the P.A.C. (1964-65) 28th Report. Detailed instructions were issued by the Board on this subject vide copy of their Circular F. No. 36|2|65-IT-AI dated 9-3-1965. In this Circular the officers were directed to ensure that such mistakes did not take place thereafter and wherever mistakes were detected for earlier years, they should be rectified.

More mistakes of the type were noticd in para 49(b) of Audit Report (Civil) on Revenue Receipts, 1968. The aforesaid Audit para was discussed in the P. A. C.'s (1968-69) 73rd Report *vide* para 3.102—3.112. It will be seen from paras 3.109 thereof that in reply to the Committee's query about action taken on their suggestion for general review (Para 11 of their 28th Report mentioned above), the then Chairman, C.B.D.T. stated: 'we issued instructions (9-3-1965) drawing particular attention to this kind of lapse and asked them also to check up the cases of all the companies, which had more than one lakh of rupees as income for two years. Recently (January, 1969) we have asked them to check up also earlier years assessments.' The above-noted instructions intended to be issued in January, 1969 could be issued only in February, 1969. The review was ordered for companies' assessment on income of Rs. 1 lakh or more. The P.A.C./Audit were apprised of this limited review ordered vide Ministry's reply dated 14-11-1969 to Para 3.112 of P.A.C.'s 73rd Report.

The scope for review was, however, widened, as desired by Audit (their letter dated 5-12-1969) covering all cases of the type (without income limit) *vide* Board's letter F. No. 17|23|69-IT(Audit) dated 13-5-1970. Reminder was issued to the commissioners on 2-12-1972, the replies received from the Commissioners were consolidated and the result intimated in the Ministry's reply F. No. 17|23|69-(Audit) dated 19-4-1973 to para 2.247 of 51st Report of the P.A.C. (1972-73).

It will be seen from the foregoing details that in 1965 general instructions were issued and as a further step in February, 1969 only a limited review was specially ordered. Before the results of the limited review could be checked, the scope of the review was revised, as desired by Audit, in May, 1970, to make it broad-based. When the general review was ordered in May, 1970, action in respect of relevant assessments (for assessment year 1956-57 to 1969-60 when the particular super tax rebate reduction provision was in operation) completed upto 1965-66 and had already been time barred *i.e.*, four years maximum time limit for rectification had expired It is in these assessments which were time-barred for rectification when the instructions for general review issued in May, 1970 that mistakes have been noticed totalling Rs. 6.96 lakhs (revenue lost). For assessments and carry forward action taken within rectification limit, remedial action is being taken, the revenue effect totalling Rs. 1.10 lakhs."

1.44. When asked whether any responsibility had been fixed for the loss of revenue of Rs 5.86 lakhs, the witness stated: "We have not issued any instruction so far for fixing responsibility." He added:

"If the mistake relate to the years 1956-57 to 1969-60, it may be a bit difficult, (although it may be possible to find out the officer who completed the assessments), to ascertain the circumstances under which the mistakes were made, the work-load they had etc."

1.45. In reply to a question, the witness deposed "The review would ordinarily be made by the Income-tax Officers who are in position when the instructions are received."

1.46. The Committee drew attention of the witness to paragraph 3.122 of their 73rd Report (1968-69) wherein the Committee were informed that a review of cases of all companies having an income of Rs. 1 lakh or more had been undertaken, and enquired whether this particular case (reported in the audit paragraph) was not one of those cases having income of Rs. 1 lakh or more, and if so, the circumstances in which this case was omitted from the review. The witness stated: "This is a case above one lakh and the assessment was completed on 18-2-1970. The first review that was ordered was in February 1969 and, therefore, according to that directive, the review would be made of the assessments which were completed prior to the issue of those instructions."

1.47. When asked whether it was not possible to fix responsibility in this case, the witness deposed: "In this case, the assessment has been rectified; there is no loss". He further added: "The Income-tax Officer has given the explanation that the previous year's folder was not available with him. That was one reason; and the other reason he gave was that he had a very large number of time-barring assessments which he had to complete, and the work-load was too heavy.'

1.48. Under the Finance Act, 1964 and 1965, certain deductions had to be made from the super-tax rebate and the deduction was limited to the extent of the rebate and the balance was to be carried forward. Failure to carry forward the deduction in this case resulted in short-levy of tax of Rs. 1.33 lakhs in the assessment year 1965-66. Similar provisions were there in the Finance Acts, 1956 to 1959. The Committee had called for a general review as early as 1964-65, in view of the fact that the lapses in computing super-tax were on the increase. This suggestion was reiterated by them subsequently during 1968-69 and 1972-73. Finally the Committee are informed that as a result of a review of company assessment cases completed during the period 1964-65 to 1967-68, under

assessment of tax to the tune of Rs. 6.96 lakhs has been noticed out of which Rs. 5.86 lakhs are to be treated as a loss of revenue as the cases are outside the time-limits for rectificatory action. The Committee cannot but deplore the fact that the review ordered from time to time was not carried out effectively and expeditiously. The Committee desire that responsibility should be fixed for this failure, which has resulted in a substantial loss of revenue. They would await the result of the action taken.

1.49. In view of what has happened, the Committee stress that every company assessment should be checked immediately by the Internal Audit after the ITO's assessment so that mistakes can be rectified within the limitation period.

1.50. The Committee have been informed that in the present case, the ITO did not have before him the folder for the preceding year where the carry forward of the rebate which was to be withdrawn had been recorded. There was also no note on this point. The Committee stress that suitable instructions should be issued to the assessing officers so as to ensure that mistakes of this kind do not recur in future.

Audit Paragraph:

1.51. Under Section 23-A of the Income-tax Act, 1922 a company in which the public are not substantially interested was liable to pay additional super-tax, when the profits and gains distributed as dividends were less than the statutory percentage specified in the Act. For the assessment year 1959-60, a company was incorrectly classified as one in which the public were substantially interested and the levy of additional super-tax was not considered, even though the dividends distributed fell considerably short of the specified statutory percentage. When it was pointed out by Audit that the correct status of the company would be one in which the public were not substantially interested and hence there would be liability for the levy of additional super-tax under Section 23-A of the Act, the department re-examined the case and levied an additional super-tax of Rs. 8,78,867.

1.52. The Ministry have stated that the assessment has been revised. Report of recovery is awaited (February, 1973).

[Paragraph 16(vii) of the Report of the Comperoller and Auditor General of India for the year 1971, Union Government (Civil), Revenue Receipts, Volume II—Direct Taxes].

1.53. The Committee wanted to know the share-holders of the company reported in the Audit paragraph. The Joint Secretary.

Ministry of Finance (Department of Revenue and Insurance) stated: "The total number of paid-up equity shares is 70,000. Out of which the share-holdings are like this:

Tube Investments Limited, Birmingham	34,150 shares.
Triton Insurance Company Ltd.	1,000 shares.
New Ambadi Private Ltd.	6,000 shares.
M.A. Muthiah	1,045 shares.
M.A. Alagappa	952 shares.

These five hold together 42,147 shares, meaning thereby 61.6 per cent of the total equity capital. In addition to this, we have got a list of persons who hold more than 100 shares. They are:

Life Insurance Corporation	1,000 shares.
A.N.I. Arunchalam HUF	441 shares.
M.A. Murugappa Individual	952 shares.
M.V. Murugappa Individual	781 shares.

1.54. The Committee wanted to know the circumstances in which the company for the assessment year 1959-60 was treated as one which the public were substantially interested by the Income-tax Officer. The witness stated: "This is a company which is registered under the Indian Companies' Act. The Company Act defines a company as a private company if it fulfils certain conditions. The assessment order of the Income-tax Officer shows that he has described its status to be a public limited company; but the records does not show whether he went into the question as to whether it is a company in which the public are substantially interested The number of share-holders is very large. It is not restricted to 50. *Prima Facie* he came to the view that this is a public limited company; but he did not go into the larger question."

1.55. When asked whether it was not correct to say that more than 50 per cent of the shares were held by a foreign company, the witness stated: "Not for this year. The Tube Investments, Brimingham holds 34,000 and odd shares. The total shares number 70,000. So it is less than 50 per cent—it is 49 per cent."

1.56. The Committee desired to know the income returned by the company for 1959-60. They also wanted to know the income

assessed and the date on which it was assessed. The Department of Revenue and Insurance in a note furnished to the Committee, stated:

"Assessment year . . .	1959-60
Income returned . .	Rs. 63,34,574
Income assessed	Rs. 6373,522
Date of assessment u/s 23(3) . .	30th November, 1959

(The income was reduced in appeal by AAC's order dated 17-2-1960. After giving effect to the AE's order. The income finally assessed was Rs. 63,33,642)."

1.57. The Committee enquired whether the case was reviewed at any time before Revenue Audit took up the Audit by any of the authorities authorised to review or inspect such as "Inspecting Assistant Commissioner, Director of Inspection or Internal Audit." The Ministry, in a note, stated: "This information is not readily avalable. It may be mentioned that the assessment was made over 14 years ago and the Revenue Audit took up the case in June, 1968. Information, if required, will be collected from the Commissioner of Income-tax."

1.58. The Committee wanted to know the date on which the first Audit query by Revenue Audit was received and the date on which the rectification order was passed. The Ministry, in a note, stated: "Audit memo. (half margin note) was received in June 1968 and the Local Audit Report was received on 19-8-1968. Order u|s 23A was passed on 12-4-1972.

[It is explained by the Income-tax Officer that interim replies were sent on 17-12-1968 and 1-7-1969. In the initial stages, the audit objection was not accepted. In the meantime, the assessment for the year 1964-65 was reopened u|s| 147(b) and the reassessment was completed on 26-5-1969 treating the company as one in which the public were not substantially interested. This reassessment was cancelled by the AAC's order dated 27-10-1969 (and the Department filed appeal to the Tribunal on 18-1-1970). The Income-tax Officer has reported that he was awaiting the outcome of the appeal to the Tribunal as the point involved was the same. However, he had issued a letter to the assessee company on 23-2-1970 calling for its objections to the proposed action under Section 23A for the assessment year 1959-60. The company sent its reply on 13-3-1970 and after that certain particulars were obtained regarding the shareholders and a report was sent to the IAC on 23-11-1970. Thereafter, the company made its representation before the IAC and another

report was submitted by the ITO to the IAC. As the initial particulars given by the company regarding the shareholders were not full and complete it was considered necessary to obtain certain further particulars which were furnished on 14-10-1971 and the ITO submitted a report to the IAC on 27-10-1971. Subsequently, the approval of the IAC was given on 7-4-1972 and order u|s 23A was passed on 12-4-1972]".

1.59. When asked whether the additional demand of Rs. 8,78,867 had since been collected, the Ministry, in a note, stated: "The additional demand of Rs. 8,78,867 has not been collected. The demand was stayed by Commissioner of Income-tax (Recovery) by order dated 11-6-1973 till the decision of the assessee's appeal to the AAC. The AAC allowed the appeal *vide* his order dated 31-7-1973 and the demand stands remitted. The Department has, however, filed an appeal to the Appellate Tribunal and intimation to this effect was sent to Audit on 2-11-1973."

1.60. The Committee enquired whether the assessments were checked by Internal Audit Party. The Ministry stated: "Records do not indicate if the case was checked by the Internal Audit Party. The Commissioner of Inome-tax has reported that as the assessment was completed in 1959, this information is not available due to lapse of time. Further, during the relevant period the scope of Internal Audit Party was limited to checking the correctness of the arithmetical calculations and the like. It was only in the year 1969 that the Board issued instruction (No. 52 dated 26-5-1969) enlarging the scope of Internal Audit."

1.61. The Committee desired to know whether the Ministry had ordered for a review of company assessments to find out whether similar mistakes were committed. The Ministry, in a note, stated: "The Board had clarified (endorsement F. No. 52|36|64-IT-Inv dated 25-7-1966) that the amendment to section 2(18) of the Income-tax Act, 1961 made by the Finance Act, 1965 will not have any retrospective effect. Therefore, for the assessment years prior to the assessment year 1965-66, shares of a company held by another company in which public are substantially interested are not to be treated as held by public. In the same letter the Board had also ordered a review of past cases to ensure that suitable action is taken in appropriate cases."

1.62. The Committee pointed out that the Ministry of Law had recently advised the Ministry of Finance regarding the term of a foreign company as a company in which the public have a sub-

stantial interest and that the advice of the Law Ministry was indicated on an application and was bound to cause more confusion. The Committee enquired whether any instructions existed in the Internal Audit Manual regarding the verification as to how a company should be treated as one in which the public have substantial interest and whether any guidelines were issued on the advice of the Law Ministry regarding the term of a foreign company as a company in which public have a substantial interest. The Joint Secretary, (Department of Revenue and Insurance) stated: "On page 21 of the supplement to Internal Audit Manual, they say: 'The Chief Auditor will personally audit certain important types of cases' and one type of case which is referred to here is 'liability to additional tax by companies in which the public are not substantially interested'."

1.63. The Member, Central Board of Direct Taxes added: "The Chief Auditor referred to was a Class I Officer and had got much experience.... The Internal Audit Manual was published in 1969. We are bringing out a new manual."

1.64. The Department of Revenue and Insurance in a note, further stated: "One of the special points for scrutiny of company cases laid down in Instruction No. 52 dated 26-5-1969 was if the company is one in which the public are substantially interested. In this context the Internal Audit Parties are required to check the list of Directors and Controlling shareholders including their relatives and nominees. Company cases with income over Rs. 10 lakhs are to be personally checked by the Chief Auditor. In this connection, page 21 and item 7 of the special chart for assessment of companies on page 37 of the Supplement to the Internal Audit Manual are relevant.

On this point the opinion of the Law Ministry became available in November 1964. On the basis of this advice, Section 2(18) of the Income-tax Act, 1961 was amended by the Finance Act, 1965. The scope of the amendment was explained in the instructions issued on the Finance Act, 1965 (para 107). Instructions were issued by the Commissioner of Income-tax, West Bengal-II to take action under Section 23A|104 in oll such cases. Subsequently, these instructions were endorsed by the Board to all other Commissioners of Income-tax (F. No. 52|36|64-IT-Inv dated 25-7-166)."

1.65. The Committee desired to know under what provisions of the Income-tax Act a foreign company not incorporated under the Indian Companies Act acquired the status of a public ompany operating in India and how it was ensured whether a foreign company

could be treated as a company in which the public were substantially interested. The Joint Secretary, (Department of Revenue and Insurance) stated: "A foreign company, strictly speaking, is not a company as defined in the Companies Act. As far as the Income-tax Act is concerned, there is a self-contained definition of the word 'company' in the Act. Section 2(17) of the Income-tax Act defines the word 'company' to mean 'an Indian company', and the word 'Indian company' is subsequently defined as a company formed and registered under the Companies Act, 1956." The question whether a foreign company is a public company within the definition of the Companies Act is perhaps not relevant to Income-tax. As far as the taxation of foreign companies is concerned, we do not make any distinction whether they are private companies or public companies. We are concerned only with the question whether a foreign company can be treated as a company in which the public are substantially interested."

1.66. The Ministry, in a written note, further stated: "Section 2(10) of the Companies Act defines the term 'company' to mean a company as defined in section 3. Section 3(1)(i) defines the term 'company' as a company formed and registered under the Companies Act, 1956 (or under the preceding Acts). Section 3(1)(iii) defines the term 'private company'. Section 3(1)(iv) defines the term 'public company' to mean a company which is not a private company.

It is clear that a company incorporated outside India is not a company formed and registered under the Companies Act, 1956 and hence such a foreign company cannot be regarded as a 'company' for the purposes of Companies Act, 1956. However, Section 591 of the Companies Act provides that companies incorporated outside India and having a place of business in India will be subject to the provisions of Section 592 to 602 of the Companies Act, 1956. Thus, these foreign companies are brought within the discipline of our Companies Act for certain purposes though, technically, they are not companies within the meaning of that term as defined in the Companies Act.

The Income-tax Act contains its own definition of the term 'company' and this definition has to be interpreted independently of the provisions of the Companies Act. Section 2(17) of the Income-tax Act defined the term 'company' to mean—

(i) any Indian company, or

(ii) any body corporate incorporated by or under the laws of a country outside India, or

(iii) any institution, association or body which is or was assessable or was assessed as a company for any assessment year under the Indian Income-tax Act, 1922 or which is or was assessable or was assessed under this Act as a company for any assessment year commencing on or before the 1st day of April, 1971, or

(iv) any institution, association or body whether incorporated or not and whether Indian or non-Indian which is declared by general or special order of the Board to be a company:

Provided that such institution, association or body shall be deemed to be a company only for such assessment year or assessment years (whether commencing before the 1st day of April 1971 or on or before or after that date) as may be specified in the declaration.

The term 'Indian company' is defined in section 2(26) and in so far as it is relevant here, it means a company formed and registered under the Companies Act, 1956. However, any institution, association or body which is declared by the Board to be a company under Section 2(17) is also regarded as a company.

For the purpose of section 23A we are not concerned with the question whether a company is a public company. We are concerned only with the question whether it is a company in which the public are substantially interested. For the satisfaction of this test, it is not necessary as one of the conditions that the company concerned should be a public ompany. The condition which is to be satisfied for this purpose is that it should not be a company which is a private company as defined in the Companies Act. A company which is incorporated outside India is a company within the meaning of the Income-tax Act, if it is declared to be a company by the Board for the assessment years upto 1970-71 and it is automatically regarded as a company from the assessment year 1971-72. Hence, this condition is satisfied by such a company incorporated outside India.

The remaining conditions in the definition in Section 2(18) will have to be satisfied by such a foreign company if it is to be regarded as a company in which the public are substantially interested within the meaning of that term for the purposes of section 104."

1.67. The Committee drew attention of the witness to their earlier recommendation contained in paragraph 2.74 of their 51st Report (Fifth Lok Sabha) wherein it was observed as under:

"The Committee feel that while a valid distinction could be made between a public company and a private company as defined in the Companies Act, the basis for differential treatment for taxation of profits of a closely held public company needs to be elucidated. They would like Government to examine the feasibility and economics of dispensing with the subtle distinction between a public company and a closely held public company for the purpose of taxation of profits, as promised during evidence. The outcome of the examination may be intimated to them."

1.68. In their reply to the above recommendation, the Ministry had stated that it would be examined and the results intimated in due course.

1.69. When asked for the decision taken in the matter, the Chairman, Central Board of Direct Taxes, stated: "The question of distinction between private and public companies from the point of view of taxation and also about Section 104 and its applicability has been discussed by a number of committees. Mr. Boothalingam had recommended that the distinction should be done away with. The Wanchoo Committee has also recommended to the same effect; but there are other considerations due to which we have not so far been able to do it; because we have found and this is one of the main considerations was that adequate dividends by private companies were not being declared as compared to the public companies with a view probably to avoid taxation at higher levels of the dividends in the hands of the shareholders. There is another thing. It is not difficult for these private companies to be registered as or to change themselves into public companies if they want to escape the regors of this law. So, from that point of view, in order to see that they do not try to evade or avoid taxation of the dividends in the hands of the shareholders, we have continued with this distinction."

1.70. On being pointed out that there was an attempt to meet this particular point in the new Company Law (Amendment) Bill, the witness deposed: "At the moment I have only indicated the thinking that has influenced the Government."

1.71. In paragraph 2.73 of their 51st Report, the Committee had observed as under:

"The Committee find that at the present the onus lies on the Department to determine whether a company is one in which public are substantially interested or not. It takes

considerable effort and time to do it. The Committee, therefore, suggest that an additional column should be provided in the income tax return to put an onus of the assessee to indicate the nature of the company."

1.72. When the attention of the witness was drawn to the above recommendation, the witness stated: "In the return of income that we have devised, we have mentioned (in part I of Annexure 4 at page 11 of the form of return—particulars for the computation of the tax liability) the words '....or a foreign company which has made the prescribed declaration'. In item 2 we have said: '....if the answer to item 1 is yes, is the company one in which the public are substantially interested *vide* Section 2(18) or a subsidiary company referred to in Section 108(b). If the answer is yes, please attach a statement'. The witness added that it was brought into effect last year.

1.73. Under the provisions of the Income-tax Act, if a company in which the public are not substantially interested, fails to distribute the prescribed percentage of its distributable income as dividends such a company is liable to pay additional super-tax. For the assessment years prior to 1965-66, shares of a company held by another company in which public are substantially interested are not to be treated as held by public. In this case additional super-tax on Rs. 8.79 lakhs was not levied for the assessment year 1959-60 as the company was incorrectly classified as one in which the public were substantially interested. Mistakes of this type have been brought to the notice of the Committee earlier also. The Committee, would, therefore, call for a review of all the completed assessments relating to the assessment years prior to 1965-66 for appropriate action. The results of the review should be intimated to the Committee.

1.74. The Committee note that the Chief Auditor of the Internal Audit is expected personally to audit certain important types of cases and one such category of cases is related to cases involving 'liability to additional tax by companies in which the public are not substantially interested'. The Committee desire that the criteria for determining whether the public have or have not substantial interest in a company should be clearly laid down in the I.A. Manual. In this connection the Committee suggest that the question how far a foreign company could be treated as one in which public are substantially interested may also be examined in consultation with the Ministry of Law.

1.75. The Committee had, in paragraph 2.74 of their 51st Report (Fifth Lok Sabha), suggested an examination of the feasibility and economics of dispensing with the subtle distinction between a public company and a closely held public company for the purpose of taxation of profits. According to the Chairman, Central Board of Direct Taxes, the distinction is necessary because it is not difficult for private companies to be registered as or to change themselves into public companies if they want to escape the rigours of taxation. The Committee understand that there is an attempt to meet this situation in the new company Law (Amendment) Bill. They accordingly wish to reiterate that the question of doing away with the distinction between a public company and a closely held public company should be considered expeditiously as a step towards simplification.

CHAPTER II

INCORRECT COMPUTATION OF INCOME FROM BUSINESS

Audit Paragraph

2.1. An Indian company incurred expenses amounting to Rs. 3,98,000 on account of 'new second preference' shares issued during the previous year corresponding to the assessment year 1967-68. Under the Income-tax Act, 1961 expenses incurred wholly and exclusively for the purpose of business are allowable as deduction from income provided such expenses are not capital in nature. The expense of Rs. 3,98,000 being one of capital in nature, was not an admissible item to be allowed as deduction from income. The department, however, allowed the entire expense of Rs. 3,98,000 as deduction in the assessment year 1967-68, resulting in under-assessment of income of same amount in that year with consequential under-charge of tax to the extent of Rs. 2,18,900.

2.2. The Ministry have stated (November, 1972) that the assessment has been revised and the additional demand rised.

[Paragraph 17(i) of the Report of the Comptroller and Auditor General of India for the year 1971-72, Union Government (Civil), Revenue Receipts, Volume II—Direct Taxes]

2.3. The Committee desired to know the provisions of the Income-tax Act, 1961, in this regard. The (Department of Revenue and Insurance), in a written note furnished to the Commitee, stated: "Under Section 37 of the I.T. Act, 1961, any expenditure (not being the expenditure of nature described in section 30 to 36 and not being in the nature of capital expenditure or personal expenses of the assessee) laid down or expended wholly and exclusively for the purposes of business shall be allowed in computing the income chargeable under the head 'profits and gains of business of profession'."

2.4. The Committee enquired whether full details of expenditure were not available with the Income-tax Officer, if so, how the incorrect allowance was made by him. The Ministry, in a note, stated: "The assessee-company had claimed a deduction of Rs. 37,60,674 under the head miscellaneous expenditure, which included a sum

of Rs. 3,98,000 incurred on the issue of second preference shares. The ITO has stated that this was not indicated in the analysis filed by the assessee. This analysis does not give the complete break up of Rs. 37,60,614 claimed under miscellaneous expenditure. But if it was not there, the ITO should have called for full particulars of this expenditure. The ITO failed to do this. If complete analysis of expenses was available such a mistake could have been avoided. Even without the analysis, there was sufficient indication in the balance-sheet about the expenditure. It appears that the I.T.O. did not make a proper study of the balance sheet. Action against the officer is under consideration."

2.5. Pointing out that objection was taken up by Revenue Audit on 11th June, 1971 but rectification under Section 154 was done on 19th September, 1972, the Committee asked how it took more than a year for rectification when the Department knew the mistake after receipt of the Audit Memo. The Member, Central Board of Direct Taxes stated "There has been delay. An explanation was called for from the Income-tax Officer. The Audit objection—half margin note—was received on 11th June, 1971. He has stated that the copy of the half margin note was not given to him. That explanation is not satisfactory. He was very much aware of the fact that objection was raised and he should have rectified the mistake immediately. Furthermore, the local audit report was received on 13th March, 1972. Even after the receipt of local audit report he should have rectified the mistake. At this stage he has stated that at that particular time he was very busy with time-barring assessments. Again between 1st April, 1972 and 11th September, 1972 when the rectificatory action was initiated by him there has been delay for which apparently there is no justification."

2.6. The Finance Secretary added: "So far as this I.T.O. is concerned I am not able to give any excuses for his conduct right from the beginning because in the first place he should have asked for the break-up of the expenditure for which rebate was claimed. Apart from that every thing was available in the balance sheet. He should have taken action immediately after the receipt of the Audit note. Since the I.T.O. is responsible for a few more lapses, we are ordering a very thorough enquiry in his work and we shall take necessary action."

2.7. In reply to a question, the Member, CBDT, stated: "Mainly these cases have been handled by the I.T.Os. and a number of mistakes committed have come to notice. We are taking action not only against the IT.Os. but we are also ordering a complete audit of these cases. An independent IAC (Audit) under the supervision of the Director of Inspection will conduct this audit."

2.8. The Ministry, in a note, stated: "The matter has accordingly been entrusted to our Director of Inspection (Income-tax Audit), who has been asked to get a special audit made through an Inspecting Assistant Commissioner (Audit)."

2.9. The Committee learnt from Audit that the assessee had preferred an appeal before the Appellate Assistant Commissioner challenging the validity of the rectificatory order. The Committee wanted to know the decision of the Appellate Assistant Commissioner. The Ministry, in a note, stated: "The assessee had challenged the rectification order in appeal before the A.A.C. The A.A.C. *vide* order dated 27th July, 1973 has cancelled the rectification order."

2.10. When asked whether the Department had preferred an appeal, the Member, CBDT stated: "We have gone in for appeal to the Tribunal. A second appeal has been filed to the tribunal."

2.11. The Ministry, in a note, added: "As per the last report received the matter is still pending before the Tribunal."

2.12. The Committe were given to understand by Audit that the I.T.O. made the assessment on 27th April, 1970 for a total income of Rs. 1,87,14,848. The Committee enquired whether the assessment was checked by Internal Audit. If not they wanted to know the reasons. The Ministry, in a note, stated: "The case was checked by the Internal Audit Party on 29th March, 1971. The mistake was, however, not detected by it. The U.D.C. concerned has, in his explanation, stated that the assessee had not shown these amounts under any head of revenue account. As there was no such item on the debit side of the profit and loss account, there was no scope for checking this point. The C.I.T. has not accepted this explanation and the U.D.C. has been warned."

2.13. The Committee are distressed to note the sheer carelessness if not something else on the part of the ITO resulted in short-levy of tax to the extent of Rs. 2.19 lakhs in this case. The ITO failed to notice that a capital expenditure of Rs. 3,98 lakhs was included under "miscellaneous expenditure' in the assessee's claim of deductions. He did not make a proper study of the company's balance sheet. What is worse was that even after the receipt of Audit objection he did not care to rectify the mistake for 15 long months. The Committee have been informed that as the officer was responsible for a few more lapses, a thorough enquiry has been ordered. The Committee stress that the cases should be thoroughly investigated and the result of investigation and action taken against officials found to be at fault intimated to them within six months.

2.14. Another distressing feature of this case is the failure of the Internal Audit to highlight the mistake. The Committee understand that an Upper Division Clerk has been warned in this connection. They wonder how the case involving a total income of Rs. 1.87 crores could be entrusted to a UDC only for check. It is clear that higher officers should also share the blame and their responsibility should be fixed. This arrangement for Internal Audit seems to be wholly unsatisfactory. This reveals serious weakness and unsuitability of the present system. The Central Board of Direct Taxes should look into this aspect immediately and ensure that high income cases are invariably checked thoroughly at appropriate level.

Audit Paragraph

2.15. In the assessment of a company, for the assessment year 1969-70, the Income-tax Officer did not accept the accounts relating to certain contract works and estimated the gross profit from such contract works as Rs. 22,301 as against loss of Rs. 9,71,883 actually debited in accounts. In framing the assessment order, however, the Income-tax Officer failed to add back the aforesaid losses to the net profits disclosed in Profit and Loss accounts. This resulted in an under-assessment of income of Rs. 6,13,900 together with a short levy of penal interest of Rs. 1,00,510.

2.16. The Ministry have accepted the mistake (February, 1973). Report regarding rectificatory action and recovery of tax is awaited.

[Paragraph 17(iii) of the Report of the Comptroller and Auditor General of India for the year 1971-72, Union Government (Civil), Revenue Receipts, Volume II—Direct Taxes]

2.17. The Committee learnt from Audit that the Ministry had accepted the objection in principle. They had originally accepted the income under-assessed to the extent of Rs. 6,13,900 and penal interest of Rs. 1,00,510 (as incorporated in the Audit para). The matter was in correspondence with the Ministry for the difference in tax effect. The Ministry had since (in their letter dated the 10th October, 1973) accepted the original Audit objection in its entirity (i.e. short-levy of tax to the extent of Rs. 6,31,722 and short-levy of penal interest of Rs. 1,21,172). Report on further action by the Department was awaited. The Committee enquired whether the assessment had since been rectified and additional tax recovered. The Department of Revenue and Insurance, in a note furnished

to the Committee, stated: "Rectification in respect of the amount of Rs. 6,13,900 has been done on 5th June, 1973. The additional demand has not yet been collected. The assessment will be further rectified in respect of additional amount of Rs. 3,57,983, acceptance of which was communicated to C&AG by letter dated 10th October, 1973."

2.18. When asked whether the case was seen by Internal Audit Party and if so, whether the objection similar to one taken by Revenue Audit was pointed out by them also, the Ministry, in a note, stated that the assessment was checked by the Internal Audit Party but it did not point out the mistake noted by the Revenue Audit.

2.19. The Committee are concerned to note that the ITO failed to add back to the net profits disclosed in Profit and Loss Accounts of the company the losses relating to certain contracts which were not accepted by him. This failure resulted in under-assessment of tax to the extent of Rs. 6.32 lakhs and short-levy of penal interest under Section 215 to the extent of Rs. 1.21 lakhs. The Committee desire that the officer should be suitably taken to task for this costly lapse. They would await a report regarding recovery of the additional tax. They would further suggest that other assessments completed by this ITO should be audited.

2.20. Although the assessment was checked by the Internal Audit Party, the mistake was not pointed out by them. The failure to detect even this simple mistake is indeed deplorable. This is indicative of lack of thoroughness on the part of the Internal Audit in exercising check. The Committee have time and again pointed out instances of this type which ought to be taken serious note of by the Ministry. Besides bringing to book the official found negligent, the Ministry should undertake a comprehensive review of the entire working of the Internal Audit in consultation with Revenue Audit to bring about qualitative improvement. In this connection they would refer to their observations contained in paragraph 2.30 of their 51st Report (Fifth Lok Sabha). In view of the urgency of the matter, the Committee emphasise that necessary action should be taken with utmost speed and reported to them.

Audit Paragraph

2.21. Under the Finance Act, 1965, companies deriving income from the manufacture of certain specified articles are entitled to a concessional rate of income-tax on such income for the assessment year 1965-66. From the assessment year 1966-67 onwards, under

the provisions of the Income-tax Act, 1961, a deduction of 8 per cent is allowed from such income and only the balance is charged to tax. The income so eligible for concessional tax rate or deduction, as the case may be, is to be determined after taking into account the allowances and deductions otherwise admissible under the Act.

2.22. An Indian company was allowed development rebate on the plant and machinery amounting to Rs. 5,50,040, Rs. 20,84,038 and Rs. 41,28,700 for the assessment year 1965-66, 1966-67 and 1967-68 respectively. The department, however, worked out the income without taking into account the development rebate so allowed. As a result, the income from which 8 per cent thereof had to be allowed deduction, was in excess by the amount of the development rebate allowed with a consequential undercharge of tax aggregating Rs. 3,00,862.

2.23. The Ministry have replied (January 1973) that the mistake has not been rectified as the proceedings initiated under section 154 have been stayed by the High Court till disposal of writ petition.

[Paragraph 17(v) of the Report of the Comptroller and Auditor General of India for the year 1971-72, Union Government (Civil), Revenue Receipts, Volume II—Direct Taxes.]

2.24. Pointing out that from the Ministry's reply it was seen that rectification proceedings under Section 154 of the Income-tax Act were initiated, the Committee enquired whether the provisions of Section 154 could be applicable in this case. The Ministry, in a note, stated: "For purpose of working out the relief for priority industry, the total income has to be determined. In determining this total income, all the admissible deductions have to be allowed. From the assessment order, it appears that the profit from priority industry has been worked out in a separate part and development rebate has been considered along with development rebate admissible on other units. This is a mistake apparent from the records and could be rectified u/s 154. It would have been possible to take action u/s 263 as well. But even this action could have been challenged by the assessee in a writ."

2.25. The Committee learnt from Audit that for the two assessment years the case was seen by Internal Audit. When asked how the mistake had escaped their notice, the Ministry, in a note, stated: "Assessments for the years 1965-66 and 1966-67 were checked by the Internal Audit Party but the mistake remained undetected. The IAP officials have explained that they checked only the tax calculations and not the computation of total income. The CIT has reported that

at present the deductions contained in Chapter VIA are also being examined by the Internal Audit.

Regarding assessment year 1967-68, the IAP could not check this case since the assessment was completed on 30-3-1971 and the Revenue Audit had already commenced the checking from 5-3-1971, in respect of this Circle."

2.26. The Committee were given to understand by Audit that two different Income-tax Officers assessed the case for the 3 assessment years. One ITO assessed for two assessment years while the other assessed the case for a single assessment year. The Committee asked for the circumstances in which the same mistake was committed by both the Income-tax Officers. The Ministry, in a note, stated: "In the computation of income the assessee had claimed concessional treatment in respect of income without deduction of the development rebate for all these years. It appears that the ITOs overlooked the fact that development rebate was not deducted in this computation."

2.27. The Committee wanted to know the steps that had been taken by the Board to safeguard recurrence of similar mistakes. The Ministry stated: "Since the relevant section (section 80 I) has been deleted from the Act with effect from 1-4-1973 *vide* Finance Act, 1972, it has been decided that no instructions are called for."

2.28. The Committee learnt from Audit that the assessee had filed a writ petition with the High Court. They wanted to know the grounds of the writ and the present position of the case. The Ministry, in a note, stated: "In the writ petition, the assessee has disputed the very fact that there was any mistake in the assessment order. It is contended that the alleged mistake, if any, is not a mistake apparent from the records. It has to be discovered by a long drawn process of reasoning and there can be two opinions about it. Action u/s 154 does not, therefore, lie. The ITO has acted without jurisdiction in commencing proceedings u/s 154.

The High Court have granted an interim injunction staying all further proceedings u/s 154. The writ petition has not been disposed of so far."

2.29. The Committee regret that in this case the assessee's computation of income claiming relief for priority industry without deduction of the development rebate was accepted for three assessment years which resulted in a short-levy of tax of Rs. 3.01 lakhs. The non-inclusion of development rebate was not noticed by two

ITOs who dealt with the assessments. The Committee desire that apart from taking suitable action against the ITOs, a test check should be conducted to see if similar mistakes were committed. The Committee consider a test check is very necessary because they have come across mistake of this type earlier also vide para 2.193 of the 51st Report (Fifth Lok Sabha).

2.30. The Committee learn that the assessee has filed a writ petition challenging the proceedings initiated under Section 154 to rectify the mistake, inter alia, **on the ground that "the alleged mistake, if any, is not a mistake apparent from the records." The Committee would await the outcome of the writ. In the meanwhile, they would like the Ministry to examine whether any amendment to the Act is necessary to ensure that rectification of patent mistakes is not frustrated by assessees seeking legal remedies on mere technical grounds.**

Audit Paragraph

2.31. A company which was raising sugarcane in its own farm and using it, along with cane purchased from the market, as raw material for producing sugar was entitled under the provisions of the Income-tax Act and the rules made thereunder, to deduct from its total income the market value of the sugarcane produced in its farm and used by it in the manufacture of sugar. The market price of sugarcane in the working seasons of 1958-59 and 1959-60 was raised retrospectively by 31 paise and 21 paise respectively per maund by an order made on 24th December, 1964 by the Sugarcane (Additional) Price Fixation Authority. As a result, the amounts deductible in respect of the sugarcane raised and utilised by the company **in the previous years relevant** to its assessments for 1960-61 and 1961-62 increased by Rs. 3,02,825 and Rs. 2,09,465 respectively and the total incomes as previously assessed in these years were correspondingly reduced in revised assessments made on 14th March 1968. These amounts were again deducted erroneously from the income assessable in 1966-67 and as a result the loss which the assessee was entitled to carry-forward, was over-assessed by Rs. 5,12,290.

2.32. The Ministry have stated that rectificatory action has been taken (January, 1973).

[Paragraph 17(vi) of the Report of the Comptroller and Auditor General of India for the year 1971-72, Union Government (Civil), Revenue Receipts, Volume II—Direct Taxes.]

2.33. The Committee learnt from Audit that the assessee had been assessed for the assessment year 1966-67 on a loss of Rs. 6,13,602 and that rectification had been done under Section 154 reducing the loss to the extent of Rs. 5,12,290.

2.34. The Committee wanted to know the provisions of the Income-tax Act in this context. The Ministry of Finance (Department of Revenue and Insurance) in a note furnished to the Committee, stated: "In computing taxable income from the business of manufacture of sugar, the market value of sugarcane raised by the factory on its farm and used in the manufacture of sugar is deductible under Rule 7 of the Income-tax Rules 1962 as this related to agricultural operations."

2.35. The Committee were given to understand by Audit that assessment for the assessment year 1966-67 was completed on 22-3-1971. The Committee asked for the date on which the revised assessment for the assessment years 1960-61 and 1961-62 was completed. The Ministry, in a note, stated: "The assessments for the assessment years 1960-61 and 1961-62 were revised on 14-3-1968 to give effect to the orders of the Appellate Assistant Commissioner"

2.36. The Committee wanted to know the circumstances under which the mistake had occurred. They also enquired whether the assessment for assessment year 1966-67 and the re-assessment for the assessment years 1960-61 and 1961-62 was done by the same Income-tax Officer. The Ministry, in a note, stated: "The assessee was raising sugarcane in its own farm and using it along with cane purchased from market, for producing sugar. The price of sugarcane for working seasons 1958-59 and 1959-60 corresponding to assessment years 1960-61 and 1961-62 was raised retrospectively by an order dated 24-12-1964 of the Sugarcane (Additional) Price Fixation Authority of the Government of India. The additional price amounted to Rs. 5,12,290 (3,02,825+2,09,465). The assessments for the assessment years 1960-61 and 1961-62 were pending on 24-12-1964. The assessee filed revised returns for both the years in which additional price of sugarcane purchased from assessee's own farm amounting to Rs. 5,12,290 was claimed as deduction. The Income-tax Officers who passed the assessment orders for assessment years 1960-61 and 1961-62 did not allow the assessee's claim. On appeal the Appellate Assistant Commissioner by his orders dated 5-2-1968 allowed the claim. The effect to the AAC's order was given on 14-3-1968. In the assessment year 1966-67 for which the previous year ended on 30-9-1965 the assessee also deducted the sum of Rs. 5,12,290 in computing its total income. This was done by the assessee because

the Price Fixation Authority's order was passed on 24-12-1964. The assessee did not file a revised return for assessment year 1966-67 after its claim was allowed by the AAC in assessment years 1960-61 and 1961-62. The Income-tax Officer failed to study the earlier record and missed the fact that the sum of Rs. 5,12,290 was already allowed on 14-3-1968 in assessment years 1960-61 and 1961-62. This led to the amount of Rs. 5,12,290 being allowed twice. The orders in question were passed by different officers as detailed below:

Assessment Year	Section	Date	Name of the ITO S/Shri
1960-61 . .	143(3) .	20-2-65	..... (A)
1960-61 . .	Revision as per AAC's order	14-3-68	..... (B)
1961-62 . .	143(3)	4-3-66	..... (B)
1961-62 . .	Revision as per AAC's order	14-3-68	..... (B)
1966-67 . .	143(3)	22-3-71	..... (C)

2.37. The Committee desired to know the extent of loss that would have been suffered if the mistake was not detected by the Revenue Audit. The Ministry in a note stated: "The ultimate tax-effect in the assessment year 1972-73 on account of the increased loss of Rs. 5,12,290 brought forward from assessment year 1966-67 is Rs. 2.90 lakhs approximately."

2.38. The Committee learnt from Audit that the assessment for assessment year 1966-67 was completed on 22-3-1971. Pointing out that this was another case where the regular assessment for asssessment for 1966-67 was done at the fag end of the limitation period, the Committee enquired whether the Board had enquired into the delay in making this assessment. The Ministry, in a note, stated: "The assessee filed the return on 8-8-1966 showing a loss of Rs. 6,71,542. The turnover was of the order of Rs. 93.83 lakhs. There were voluminous accounts and statements to be scrutinised. For administrative reasons there were also some changes in the Income-tax Officers holding jurisdiction over this case. The assessment, therefore, took some time and was ultimately finalised on 22-3-1971."

2.39. Referring to the fact that the market price of sugarcane in the working seasons of 1958-59 and 1959-60 was revised retrospectively by 31 paise and 21 paise respectively per maund by an order made on 24th December, 1964 by the Sugarcane (Additional) Price Fixation Authority, the Committee wanted to know the circumstanc-

es in which sugarcane price was revised after a period of nearly 6 years retrospectively and whether the fixation of minimum/maximum price was done. The Ministry, in a note, stated: "The additional price payable for sugarcane purchased during working seasons 1958-59 and 1959-60 was fixed by an order dated 24-12-1964 of the Sugarcane (Additional) Price Fixation Authority of the Ministry of Food & Agriculture of the Government of India. The price fixation was done under the Sugarcane (Control) Order 1955, as amended on 1-11-1962 with retrospective effect from 1-11-1958."

2.40. The Committee enquired whether after issue, the transaction was completed and accounts closed, the unauthorised liability arose merely by reasons of the Sugarcane Price Control Order and whether in regard to purchases from open sources such enhanced price was paid. The Committee further enquired whether the accounts of the years 1958-59 and 1959-60 were reopened by the assessee and actually the enhanced amount had been debited. The Ministry, in a note, stated: "The correct legal position appears to be that the liability for the additional price arose on 24-12-1964 when the order of the Sugarcane (Additional) Price Fixation Authority for assessment years 1960-61 and 1961-62 corresponding to working seasons 1958-59 and 1959-60 were pending on 24-12-1964. The accounts of the previous years of the assessment years 1960-61 and 1961-62 were not reopened but the assessee filed revised returns for both the years in which it claimed deductions on account of the additional price payable for the sugarcane used during the two seasons. The additional price payable for the sugarcane from its own farm amounted to Rs. 5,12,290 (3,02,825+2,09,465). The Income-tax Officers who passed the assessment orders did not allow the assessee's claim. On appeal the claim was allowed by the Appellate Assistant Commissioner. The AAC's decision relating to this allowance was accepted by the Commissioner.

Enhanced price was also paid in regard to purchase from open sources."

2.41. In computing taxable income from the business of manufacture of sugar, the market value of sugar-cane raised by the factory on its farm and used in the manufacture of sugar is deductible under the Rules as it relates to agricultural operations. Consequent on the retrospective increase of market price of sugar-cane in the working seasons of 1958-59 and 1959-60 by an order dated 24-12-1964, the assessee filed revised returns for the relevent assessment years viz., 1960-61 and 1961-62, in which additional amount of Rs. 5,12,290 was claimed as deduction. This was allowed in the revised assessments completed on 14-3-1968. In the meanwhile, the

assessee filed the return for the assessment year 1966-67 on 8-8-1966 wherein the same amount of Rs. 5,12,290 was deducted from total income which was also allowed by the ITO. The deduction allowed twice had a tax effect of Rs. 2.9 lakhs. The ITO, who completed the assessment for the year 1966-67 appears to have been grossly negligent in that he failed to do something which was clearly his duty to do, namely to scrutinise properly the loss of Rs. 6.72 lakhs returned by the assessee. As the assessee must have given the reasons for the deduction it should have been possible for the ITO to have linked it up with the revised assessments for the years 1960-61 and 1961-62. The Committee require that appropriate inquiry and action should be initiated. They further suggest that other assessments completed by this ITO should be audited.

2.42. According to the Ministry, the correct legal position appears to be that the liability for the additional price arose on 22nd December, 1964 when the order of the Sugarcane (Additional) Price Fixation Authority was passed. It would, therefore, seem to be not correct to have reopened the assessments for the assessment years 1960-61 and 1961-62 in this case. The Committee would like to know how the enhanced price stated to have been paid by the assessee in regard to purchases from open sources was dealt with in the relevant assessments. The Committee further desire that the correct position in law should be clarified for the guidance of the officers concerned.

2.43. The Committee find it somewhat difficult to understand the circumstances which could have led Government to come to the conclusion that it was necessary to revise the price of sugarcane retrospectively after a period of nearly 6 years and how such a revision could possibly have subserved the interest of the producers of sugarcane and the general public.

2.44. Incidentally the Committee find that in this case the assessment for the year 1966-67 was completed on 22-3-1971 when it was about to become time-barred. The rush of assessment at the end of the limitation period may often lead to mistakes of a costly nature as in this case being committed. It is regrettable that frequent changes in the ITOs continue to take place. The Committee have earlier in this Report expressed their dissatisfaction over such frequent changes which must necessarily affect the work of the Department adversely.

Audit Paragraph

2.45. A company received 14,340 bonus shares of the face value

of Rs. 10 each from another company and debited its revenue account with Rs. 1,43,400 representing the cost of these shares. As the acquisition of bonus shares was only an accretion to the capital value of its investments and not a revenue expenditure, the debit should have been disallowed by the Income-tax Officer. In this case when the return for the concerned assessment year (1959-60) was submitted in November, 1963, the sum of Rs. 1,43,400 was included in the return but subsequently in December, 1963, the assessee submitted a revised return reducing the income by taking into account the debit of Rs. 1,43,400 purporting to follow a High Court judgment delivered in its case. However, in March, 1964 the said High Court's judgment was reversed by the Supreme Court which clearly stated that there could not be any separate debit for the bonus shares in the accounts. On 28th March, 1964 the assessment of the case was completed after the Supreme Court judgment; however, the Supreme Court judgment was not given effect to. Even subsequently, when the assessment was revised in August, 1969 to give effect to the order dated 25th April, 1969 of the Appellate Tribunal, the inclusion of the debit of Rs. 1,43,400 was not rectified with the result that there was an under-charge of tax of Rs. 73,851.

2.46. The Ministry have reported (February, 1973) that the assessee has been persuaded to accept rectification even though it is time-barred. The rectification was accordingly carried out with the result that the business income of 1959-60 has been increased by a sum of Rs. 1,43,000 and the entire amount has been sent-off against the business loss of earlier year.

[Paragraph 17(vii) of the Report of the Comptroller and Auditor General of India for the year 1971-72, Union Government (Civil), Revenue Receipts, Volume II, Direct Taxes].

2.47. The Committee were given to undrstand by Audit that the Ministry, while accepting the objection, had intimated that no timely action could be taken for the reasons that:

(i) non-Availability of Supreme Court judgement to the Income-tax Officer at the time of the assessment,

(ii) expiry of time limit for rectification when effect was given to the Tribunal order.

However, rectification has been done with the consent of the assessee.

2.48. Referring to the revised return submitted by the assessee in December, 1963 reducing the income by taking into the debit of

Rs. 1,43,400 purporting to follow a High Court judgement delivered in its case, the Committee enquired whether it was not, on the fact of it, a deliberate evasion. The Member, Central Board of Direct Taxes stated: "The assessee was placing reliance on the Patna High Court decision, which he thought, was in his favour. The assessee claimed deduction for an amount of Rs. 1,43,400 on account of bonus shares."

2.49. The Committee wanted to know the date on which the Patna High Court gave its judgement and also the date on which the assesssee submitted his original return. The Department of Revenue and Insurance, in a written note furnished to the Committee, stated: "The judgement was delivered by the Patna High Court on 28-11-1960. The assessee had ubmitted the original return on 19-8-1960."

2.50. The Committee enquired whether between two dates of submission of the original return and revised return, any proceedings for assessments were started by the Income-tax Officer. The Ministry, in a note, stated: "Three revised returns were filed by the assessee on 30-11-1961, 18-11-1963, 7-12-1963. The I.T.O. in this case issued questionnaire on 4-12-1962. The case was fixed for hearing for 5-9-1963. Before the final revised return was filed, the I.T.O. gave hearings on 5-11-1963, 12-11-1963, 18-11-1953, 20-11-1963, 22-11-1963 and 26-11-1963."

2.51. The Committee asked whether, when the revised return was taken up for assessment, the Income-tax Officer was not aware at least that the Patna High Court judgement was not accepted by the Department and was under appeal to the Supreme Court. The Ministry, in a note, state: "The decision of the Board in not accepting the Patna High Court judgement was contained in the bulletin for the quarter ending 30-9-1961 which was circulated to all the Officers. The I.T.O. must have been aware of the position." Pointing out that the High Court judgement was reversed by the Supreme Court and that reversal took place in March, 1964, the Committee enquired whether, at the time of passing the order, it was not the duty of the Income-tax Officer to verify whether the appeals had been disposed of by the Supreme Court and ascertain the result. The Member, CBDT replied in the affirmative. He added: "It was his business. The Supreme Court decision was on 13-3-1964 and the assessment was made on 28-3-1964. Presumably, the Income-tax Officer was not aware of it."

2.52. When asked whether the assessment was completed very much in time, the witness replied: "He completed it on 28th March 1964; 31st March would have been the limitation."

2.53. The Committee wanted to know the reasons for not taking any action for re-assessment when the copy of the judgement was received within the time for rectification under Section 154 or for action under Section 263. The Ministry, in a note, stated: "The judgement was received within the time for rectification u|s. 154 or for action u/s. 263. The I.T.O. went on deputation in July, 1964 and the successor I.T.O. did not know that the assessment in question had been completed by his predecessor following the judgement of Patna High Court as no note had been left in the assessment order."

2.54. The Committee pointed out that even subsequently when the assessment was revised in August 1969 to give effect to the order dated 25th April, 1969 of the Appellate Tribunal, the inclusion of the debit of Rs. 1.43 lakhs was not rectified. When asked for the reasons, the witness stated: "The I.T.O. who gave effect to the Tribunal order, did not know because no note had been left by the earlier I.T.O..... Instructions are there. He should have left a note for the successor I.T.O."

2.55. The Committee further enquired whether, at least on receipt of the assessment orders, it was not the duty of the assessee to bring the fact of the judgement to the notice of the I.T.O. The Ministry, in a note, stated: "There was no legal duty cast on the assessee to bring to the notice of the I.T.O. the fact of the judgement of the Supreme Court in this case."

2.56. The Committee wanted to know the procedure for keeping Income-tax Officers informed the Supreme Court judgement in Tax cases and the time taken for an I.T.O. to get copies of judgements in the case dealt with by them. The Committee also desired to know the date on which the copy of the judgement of this particular case was received by the Commissioner and when it was forwarded to the Income-tax Officer. The Ministry, in a note, stated: "In respect of Supreme Court decisions, apart from the fact that the Income Tax Reports in which they are invariably reported are being supplied to field officers, important decisions were and are being reviewed by the Board and instructions are issued wherever necessary.

In the instant case the CIT received the judgement on 1-7-1964 *vide* Board's F. No. 75|149|63-IT(J) dated 24-6-1964 and the same was communicated to the I.T.O. concerned on 14-7-1964"

2.57. The Committee asked whether the Government had investigated to find out whether the omission of the assessee to point out the correct position regarding his appeal or the omission of the I.T.O. to take action in time, was bona fide. The Ministry, in a note, stated: "The explanation given by the officials concerned has been accepted by the C.I.T. and he has observed that no mala fides can be attributed to that action. There is nothing to indicate that the omission of the assessee to point out the correct posiion regarding his appeal was mala fide."

2.58. In this case the assessee submitted a revised return in December, 1963 reducing the income by taking into account the debit of Rs. 1.43 lakhs representing the cost of bonus shares received from another company, purporting to follow a High Court judgement. This judgement was delivered by the High Court on 28-11-1960. The decision of the Board in not accepting the High Court judgement was contained in the bulletin for the quarter ending 30-9-1961 which was circulated to all the officers. The I.T.O. must have, therefore, been aware of the position. Yet he did not ascertain as to what happened to the further appeal preferred against the High Court judgement nor did he keep a note to facilitate revision of the relevant assessment. In the meantime, the High Court judgement was reversed by the Supreme Court in March, 1964. Unfortunately by the time Supreme Court judgement was communicated, the ITO had left on deputation and his successor was not aware that he had completed the assessment in question following the judgement of the High Court. To say the least, all this indicates a very unsatisfactory system of working The Committee desire that the lapses on the part of the ITO should be carefully gone into for apropriate action under advice to them and suitable instructions should be issued promptly to al lthe assessing officers with a view to preventing lapses of this kind.

Audit Paragraph

2.59. Under the Income-tax Act, exemption is admissible to the profits and gains derived from a newly established industrial undertaking as do not exceed 6 per cent of the capital employed in such undertaking. Where such profits and gains fall short of 6 per cent of the capital employed, such short-fall or deficiency can be carried forward to a prescribed number of succeeding years for set-off against profits and gains of those years. This carry-forward of deficiency, however, was admissible for assessment year 1967-68 and subsequent assessment years and was not available for profits assessable in the assessment year 1966-67.

2.60. The department, however, allowed the carry-forward of a profit deficiency of Rs. 2,58,318 in respect of a newly established undertaking of an assessee company for 1966-67 for set-off against the profits and gains of the subsequent assessment years 1967-68 to 1969-70. The incorrect carry-forward of profit deficiency resulted in a total under-charge of tax of Rs. 1,42,074 for the assessment years 1967-68 to 1969-70.

2.61. The Ministry have replied (December, 1972) that the mistake has been rectified. Report of recovery of the additional demand of tax is awaited.

[Paragraph 17(viii) of the Report of the Comptroller and Auditor General of India for the year 1971-72, Union Government (Civil), Revenue Receipts, Vol. II—Direct Taxes].

2.62. The Committee learnt from Audit that the Ministry had accepted the mistake and reported that the assessments in question had been rectified and an additional demand of Rs. 1,42,074 raised and collected. The Committee wanted to know whether the assessment for 1966-67, wherein the carry-forward of deficiency was directed to be allowed, was completed by the Same Income-tax Officer who completed the assessments for the assessment years 1967-68 to 1969-70 wherein the carry-forward deficiency was actually setoff against the profits and gains of these assessment years.

2.63. The Department of Revenue and Insurance, in a note, directed to be allowed, was completed by the Same Income-tax Officers as below:

Asstt. Year	*Name of the I.T.O.*
1966-67	Shri..... .....
1967-68	Shri.....
1968-69	Shri .....
1969-70	Shri .....

2.64. The Committee asked for the circumstances under which the mistake was committed. They also enquired whether the Board had directed the Inspecting Assistant Commissioner to check all such assessments completed by the same I.T.O. The Ministry, in a note, stated: "Relief u/s 90J was allowable in the assessment year 1966-67 to the extent of Rs. 3,57,127 being 6 per cent of capital employed in the new industrial undertaking of the company. Rebate was actually allowed only to the extent of Rs. 98,809 being profit and gains of the new undertaking. The deficiency of Rs. 2,58,318 instead of being allowed to lapse as was appropriate for Assessment

Year 1966-67 was wrongly carried forward for set off against the profits derived in the subsequent Assessment Years 1967-68 to 1969-70. The Board have asked the C.I.T. to direct the I.A.C. to carry out an inspection of the I.T.O.'s work in the relevant circle for detecting possible mistakes in other important (Category I & II) cases and to send a report to the Board."

2.65. Pointing out that the three assessments were reported to have been checked by Internal Audit, the Committee asked how the mistake had escaped their notice. The Ministry, in a note, stated: "The I.A.P. official has explained that he checked the case bue could not detect the mistake due to oversight. He has been warned. C.I.T. has been asked to shift the official who was supervisor from I.A.P. and post an Inspector in this place."

2.66. The Committee desired to know the number of new Industrial Undertakings which had been benefited by this Section 80J, and out of them, the number of which would fall in the Small Scale Sector. The Ministry, in a note, state: "Information is available in respect of industrial undertakings which were granted concession u/s 80J in the financial year 1971-72. In all 337 new industrial undertakings (225 companies and 82 no-companies) were granted the relief u|s 80J.

The Department does not have the further bifurcation as to the number of assessees who fall in the small scale sector out of the avobe 337 assesses."

2.67. Under the Income-tax, exemption is admissible to the profits and gains derived from a newly established industrial undertaking to the extent of 6 per cent of the capital employed in such undertaking. Where they fall short of 6 per cent, carry forward of defiiciency was admissible only from the assessment year 1967-68. However, in this case a deficiency of Rs. 2.58 lakhs for 1966-67 was allowed to be carried forward which resulted in a total undercharge of tax of Rs. 1.42 lakhs for the assessment years 1967-68 to 1969-70. The Committee learn that the CIT has been asked to direct the IAC to carry out an inspection of the concerned ITOs work. The Committee would await a report in this regard.

2.68. The Committee incidentally note that during the financial year 1971-72 in all 337 new undertakings were granted 'tax holiday' relief under Section 80J. Unfortunately the Department is not in a position to indicate the number of such undertakings which fall

in small scale sector. It would be of interest and value to know the number of undertakings in the small scale sector, which benefited from this concession and the Committee trust that the Ministry will take suitable steps to ensure that this information is readily available. In this connection the Committee would recall their suggestion contained in paragraph 7.15 of their 87th Report (Fifth Lok sabha).

CHAPTER III

MISTAKES IN COMPUTING DEPRECIATION AND DEVELOPMENT REBATE

Audit Paragraph

3.1. The Public Accounts Committee had repeatedly drawn the attention of the Ministry to the need to avoid mistakes in computation of depreciation allowance and development rebate. The mistakes have continued to occur involving considerable revenue. During the year under report, 797 cases (both companies and non-companies assessments) of underassessment of tax due to iccorrect allowance of depreciation and development rebate involving Rs. 102.77 lakhs were noticed in test-check. A few instances relating to companies are mentioned below.

3.2. Under the provisions of the Income-tax Act the grant of development rebate is, among others, subject to the following two conditions:—

(1) The plant and machinery should be new.

(2) Development Rebate is admissible only in respect of the year of installation.

3.3. A company was incorporated on 18th February, 1959 after taking over all the assets and liabilities of an existing company. The plant and machinery so taken over had been installed by the latter company long before the incorporation of the former company. So the two conditions referred to above were not satisfied and the former company was not eligible for development rebate in respect of the plant and machinery so taken over. But the department allowed development rebate to the former company to the extent of Rs. 33,04,401 for the assessment year 1960-61. This irregular allowance of development rebate resulted in undercharge of tax of Rs. 14,86,980 for the said assessment year.

3.4. The Ministry have replied (February, 1973) that the audit objection does not appear to be acceptable to them in view of an agreement dated 27th June, 1971 between the Government of India and the companies concerned and a subsequent clarification by the

Board in respect of the said agreement. They have, however, added that the matter is being examined further.

[Paragraph 18 (i) of the Report of the Comptroller and Auditor General of India for the year 1971-72, Union Government (Civil), Revenue Receipts. Volume II—Direct Taxes].

3.5. The case reported in the Audit paragraph relates to *M/s.* Oil India Ltd., a joint venture of Government of India and Burmah Oil Company was incorporated on the 18th February, 1959 with 33-1|3 per cent Government participation. Subsequently, by a Second Supplemental Agreement of 27th July, 1961 the shareholding of Government of India was increased to 50 per. cent.

3.6. The Assam Oil Co., a subsidiary of Burmah Oil Co. had been granted a geophysical licence on a certain area in Naharkatiya in Assam for prospecting for oil. The company struck oil in 1953. The Government of Assam agreed, with the approval of the Government of India to grant to the Assam Oil Co. a mining lease in Naharkatiya for production of oil in an adjacent area called Naharkatiya Extension. The grant of this mining lease and prospecting licence was conditional on that the Assam Oil Co. would set up a rupee company to which both these concessions would be transferred. The Oil India Ltd. was incorporated in consequence of this condition.

3.7. According to the Promotion Agreement executed on 14-1-1958 among the Government of India, Burmah Oil Co. and the Assam Oil Company the following financial arrangements were *inter-alia* laid down:

(1) Oil India would reimburse the Assam Oil Co. all expenses incurred in connection with the surveys explorations, prospecting operations till the date of transfer.

(2) Oil India would also pay the cost of all assets and properties transferred by the Assam Oil Company at cost less any depreciation and any development rebate allowed to the Assam Oil Company or to which the Assam Oil Co. May be entitled at the date of transfer under the Income-tax Act.

(3) The Assam Oil Co. would provide Oil India with all its experience and data with regard to the lease and licensed areas and in particular all geological and geophysical data accumulated by it in the past, the advantages of its past research, particularly with respect to the recons-

truction of the complex structural and sedimentary history of the areas and studies of oil migrations and primary and secondary accumulations etc. in consideration of the Oil India supplying to it for a period of 20 years a certain portion of its produce in terms of oil and natural gas at a concessional rate.

(4) The Assam Oil Co. would render to Oil India at actual cost certain specific services such as workshop, accommodation, hospital, geological, drilling, production engineering, transport and store-keeping etc.

3.8. Against the expenses and the costs mentioned in items 1 and 2 of the preceding paragraph, a payment of Rs. 13,14,41,569 was made to the Assam Oil Co. This amount included *inter-alia* the following:

(i)	Intangible expenses such as consultant fees, geological and geophysical expenses, cost of servicing wells etc.		Rs. 189·06 lakhs
(ii)	Lands, roads and bridges		Rs. 44·99 ,,
(iii)	Cost of oil wells : Drilling costs	620·30	Rs. 727·50 ,,
	Casting and Tubing	107·20	
(iv)	Building, Plants and Machinery		Rs. 161·04 ,,
	TOTAL		Rs. 1122·59 ,,

3.9. In the second Supplemental Agreement signed on 27-7-1961 a specific provision in respect of taxation of Oil India was made in view of Section 42 of the Income-tax Act, 1961 [Section 10(2)AA of the Act, 1922]. This Section in the Act provides that in the case of business for prospecting or extraction or porduction of mineral oils, in relation to which the Goverhment of India have entered into a participation agreement, amortization of the following expenditure would be allowed in accordance with the provisions of the agreement:

(a) Expenditure by way of infructuous exploration expenditure in respect of any area surrendered prior to the commencement of commercial production.

(b) After the commencement of commercial production, expenditure incurred by the assessee whether before or after such commercial production in respect of drilling or exploration activities except for the assets on which depreciation allowance is admissible.

(c) In respect of depletion of mineral oil, in the assessment year relevant to the previous year in which commercial production has begun and for the specified succeeding year or years.

Since no areas was surrendered in the precent case in effect, the Act allowed a provision being made by the agreement for the amortization of expenditurhe incurred by the assessee in respect of drilling or exploration activities and for the normal depreciation admissible under the Act.

3.10. The taxation provision made in the Second Supplemental Agreement contained the following two provisions in respect of the pre-incorporation expenditure mentioned in paragraphs 4:

(a) In respect of the expenditure (Rs. 161.04 lakhs) on building, plant and machinery "usual depreciation/development rebate will be allowed each year as provided under Income-tax Act, 1922".

(b) In respect of the rest of the expenditure of Rs. 916.55 lakhs, Rs. 961.56 lakhs minus Rs. 44.99 lakhs representing cost of land, roads and buildings amortization over a period of 15 years at the rate of Rs. 61 lakhs per annum would be allowed.

3.11. These provisions were made in consultation with Central Board of Revenue and the Ministry of Law.

3.12. In its assessment for the year 1960-61 (Accounting year 16-2-1959 to 31-12-1959), the Company claimed depreciation and development rebate on the pre-incorporation expenditure on building, plant and machinery and on casing and tubing.

3.13. The Committee asked for the date on which these plant and machinery were acquired by the Assam Oil Company and whether in the assessment of Assam Oil Company, these assets were allowed depreciation and development rebate. Wherever it was not allowed the Committee wanted to know the reasons that were recorded for not allowing the claim. The Ministry in a note, stated: "The position is being ascertained from the Commissioner of Income-tax (Central), Calcutta and a further reply will follow."

3.14. The Committee enquired whether the allowance of development rebate to Oil India, which had taken over the assets from Assam Oil Company, was in accordance with the provisions of law relating to allowance of development rebate; if not, how the Ministry

agreed to this allowance. The Committee also wanted to know whether the Government of India could enter into an agreement with companies and ignore the Income-tax Law. The Joint Secretary, Department of Revenue and Insurance stated: "The position is like this. Section 12(2AA) introduced in 1922 Act authorises the Government to give certain allowances for oil prospecting business in which the Government was associated. And if there is an agreement between the Government of India and that party and if that agreement provides for any special allowances, they were sought to be regularised by this amendment in the Income-tax Law. The corresponding section is 42 in the present act."

3.15. The witness added: "There were a series of agreements between the Government of India and the Burmah Oil Company, Oil India Limited and Assam Oil Limited. The first agreement is promotion agreement of 14-1-1958. The second agreement, called Supplemental Agreement is dated 16-2-1959 and the Adopting Agreement is dated 14-3-59. Then there is an agreement called 'Second Supplemental Agreement' between the same parties dated 27-7-1961. Clause 12 of this agreement provides for certain concessional tax treatment of Oil India Ltd. One of the clauses—sub-clause (iv) of clause 12—says that on expenditure incurred on buildings, plant and machinery prior to the incorporation of Oil India and taken over by Oil India, the usual depreciation and development rebate will be allowed as provided in the Income-tax Act, 1922. It appears that acting under this clause 12(iv) of the agreement, the Income-tax Officer took the view that development rebate on the machinery taken over by Oil India Ltd. from Assam Oil Company Ltd. was allowable."

3.16. Asked whether it was a reasonable view to take, the witness deposed: "The matter does not appear to be free from doubt and we are consulting the Law Ministry whether in view of clause 12(iv) of the agreement development rebate was admissible or not."

An extract of clause (IV) is given below: "On expenditure incurred on building plant and machinery prior to incorporation of Oil India and taken over by Oil India usual depreciation/development rebate will be allowed each year as provided under the Indian Income-tax Act, 1922."

3.17. On being pointed out that clause 12(iv) stated that the *usual* allowance should be permitted and that the Commissioner could not give beyond that, the witness stated: "That is the whole point at

issue—as to what is the exact effect of this clause 12(iv). The Commissioner interpreted it one way and the question whether that interpretation is correct or not."

3.18. The Ministry, in a note, further stated: "The question whether the allowance of development rebate is in accordance with provisions of law is under examination in consultation, with the Ministry of Law.

It may, however, be stated that the Commissioner of Income-tax (Central), Calcutta had sought Board's instructions in his letter No. 6A|58|1962-63 dated 17-11-62 on Oil India's claim for depreciation and development rebate. Board's file No. 10|68-62-IT(AI) in which the Commissioner's reference was dealt with has been destroyed. Copies of the correspondence have been taken from the Commissioner's file.... In para 3 of the Commissioner's letter dated 17-11-62 he had expressed the view that the claim for depreciation and development rebate in respect of building, plant and machinery installed prior to incorporation would be admissible in view of sub-clause (iv) of clause 12 of the Second Supplemental Agreement. In para 4 of the said letter he had referred to the allowance of development rebate on expenditure incurred on casing and tubing and expressed the view that no development rebate was admissible on that expenditure. The Board in its letter dated 4-4-63 wanted confirmation that Assam Oil Company had given up its claim for depreciation allowance and also did not claim development rebate on assets taken over from it by Oil India. Regarding the allowance of development rebate on casing and tubing, the Board wanted to know what treatment could be given to those items for purposes of depreciation allowance. In this letter dated 17-4-63, the Commissioner confirmed that Assam Oil Company had given up its claim for depreciation allowance and did not also claim development rebate on assets transferred by it to Oil India. In this letter, the Commissioner also dealt with the clarification sought by the Board about the treatment to be given to casing and tubing for purposes of depreciation allowance. Further correspondence was confined to the admissibility of depreciation and development rebate on casing and tubing and the Board after consulting the Law Ministry advised the Commissioner from F. No. 10|70|64-IT(AI) that the benefit of development rebaet with regard to casing and tubing relating to pre-incorporation period can be allowed on the company's withdrawing its claim for the depreciation allowance for the pre-incorporation period."

3.19. The Committee wanted to know the date on which the matter was referred to the Ministry of Law and whether their opinion

in the matter had been obtained. They also desired to know whether the matter was referred to the Law Ministry at any of the earlier stages. The Ministry, in a note, stated: "The matter was referred to the Law Ministry on 6th September, 1973. Our file was later on withdrawn as it was required in connection with the PAC meeting held in November.....The matter will again be taken up with the Law Ministry.

Our available files do not show that any reference was made by this Ministry to the Ministry of Law at any of the earlier stages on the general question whether development rebate is admissible on machinery taken over by Oil India from Assam Oil Co. Ministry's file No. 3(2)|6-IT(AI) contains at page 82|cor. a copy of note recorded in the file of the Department of Mines and Fuel, which shows that the draft of clause 12 (taxation clause) had been approved by the Ministry of Law.

As already indicated earlier the Board had consulted the Law Ministry while advising the Commissioner of Income-tax from File No. 10/70/64-IT(AI) that the benefit of development rebate with regard to casing and tubing relating to pre-incorporation period can be allowed on the company's withdrawing its claim for depreciation allowance for the pre-incorporation period."

3.20. The Committee enquired whether the Central Board of Revenue was consulted when the original or modified agreement was entered into, particularly before clause 12(iv) of the modified agreement was put in. The Joint Secretary stated: "Central Board of Revenue was consulted at the time of clause 12(iv) was drafted."

3.21. When asked whether any objection was raised by Central Board of Revenue to this particular clause the witness replied in the negative.

3.22. The Committee wanted to know the circumstances under which the modified agreement was entered into. The Ministry, in a note, stated: "The position is being ascertained from the Ministry of Petroleum and Chemicals and a further reply will follow."

3.23. The Committee desired to know the advice given by the Central Board of Revenue and also whether there was any examination of this clause in the Board with reference to tax liability before the advice was given. The witness stated: "There are some notings on the file and we are trying to understand these notings, As far as I can understand from these notings, they are to the effect that there was no intention of giving any development rebate in relaxation of the basic provisions of the Law. That is my understanding."

3.24. The Ministry, in a note, further stated: "In Board's F. No. 3(2)|61-IT(AI) in the noting recorded on 22-5-61 there is reference to the discussions on the various taxation points arising from the negotiations leading to the conclusion of the Heads of Agreements on 31-5-1961.

The Board was associated with the drafting of Clause 12 relating to taxation in the Second Supplemental Agreement dated 27-7-1961. The reference from the Department of Mines and Fuel was dealt with in Board's file No 3(2)|61-IT(AI).

Apart from drafting changes made, the main changes are in sub-clause (iii) and by way of insertion of sub-clause (iv). In sub-clause (iii) of the Heads of Agreements, the pre-incorporation expenditure to be amortised was shown as 'presently estimated at Rs. 8 crores'. This figure was assessed by the Assessment Committee at a figure of Rs. 916.56 lakhs exclusive of the amounts in respect of lands, roads, bridges, plant and machinery. The break-up of this figure is as under:

Geological and geophysical expenditure .	Rs. 153·54	lakhs.
Cost of servicing wells and test production .	Rs. 32·49	lakhs.
Cost of oil wells	Rs. 727·50	lakhs.
Consultants' fees and other intangible expenses .	Rs. 3·03	lakhs.
	Rs. 916·56	lakhs.

Spread over a period of 15 years, the annual depletion allowance would be Rs. 61.10 lakhs (or say Rs. 61 lakhs) which was ultimately adopted in clause 12(iii) of the Second Supplemental Agreement.

Sub-clause (iv) was suggested by Burma Oil Company. The relevant noting in the Board's file is given below:

> *Sub-clause (iv)*: This sub-clause has been newly inserted by the BOC. It lays down that the usual amount of depreciation|development rebate will be allowed each year in accordance with the provisions of the IT Act, in respect of pre-incorporation expenditure of Oil India on buildings, plant and machinery. Such expenditure as per the note of the Cost Accounts Branch, amounts to Rs. 161.04 lakhs. Even without introducing any specific provision in the agreement in this behalf, depreciation allowance and

in the matter had been obtained. They also desired to know whether the matter was referred to the Law Ministry at any of the earlier stages. The Ministry, in a note, stated: "The matter was referred to the Law Ministry on 6th September, 1973. Our file was later on withdrawn as it was required in connection with the PAC meeting held in November.....The matter will again be taken up with the Law Ministry.

Our available files do not show that any reference was made by this Ministry to the Ministry of Law at any of the earlier stages on the general question whether development rebate is admissible on machinery taken over by Oil India from Assam Oil Co. Ministry's file No. 3(2)|6-IT(AI) contains at page 82|cor. a copy of note recorded in the file of the Department of Mines and Fuel, which shows that the draft of clause 12 (taxation clause) had been approved by the Ministry of Law.

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Spread over a period of 15 years, the annual depletion allowance would be Rs. 61.10 lakhs (or say Rs. 61 lakhs) which was ultimately adopted in clause 12(iii) of the Second Supplemental Agreement.

Sub-clause (iv) was suggested by Burma Oil Company. The relevant noting in the Board's file is given below:

> *Sub-clause (iv)*: This sub-clause has been newly inserted by the BOC. It lays down that the usual amount of depreciation|development rebate will be allowed each year in accordance with the provisions of the IT Act, in respect of pre-incorporation expenditure of Oil India on buildings, plant and machinery. Such expenditure as per the note of the Cost Accounts Branch, amounts to Rs. 161.04 lakhs. Even without introducing any specific provision in the agreement in this behalf, depreciation allowance and

development rebate that might be admissible to the Oil India under the IT Act would be normally allowable. However, the justification given by the BOC for introducing this sub-clause is that clause 10(iii) of the Heads of Agreement (page 74|cor.) which provides for the amortisation of pre-incorporation expenditure of the OIL (other than on buildings, plant and machinery) over 15 years expressly lays down that for buildings, plant and machinery, the usual income-tax depreciation|development rebate as provided under the IT Act will be allowed and because in clause 12(iii) of the proposed final agreement a specific figure has now been mentioned in regard to annual depletion allowance, it is necessary now to clarify that OIL would be entitled to depreciation|development rebate also in respect of buildings, plant and machinery, over and above the aforesaid depletion allowance. Shri Uttam Singh of the BOC, who saw me in this connection, urged that the BOC's London office was very keen that this new sub-clause which is of a clarificatory nature should be retained in order to remove any scope for misapprehension in future. He indicated that if this sub-clause is not allowed to be retained, it will be necessary to clarify the position by exchange of letters between the BOC and the Government.

'The sub-clause is not necessary, but as it is purely of a clarificatory nature, there may perhaps be no objection to its retention'."

3.25. In reply to a question the Finance Secretary stated during evidence: "There were a series of agreements between the Government, Burmah Oil Company and the Assam Oil Company and certain concessions were given in the agreements. Now, it is quite clear that the Central Board of Revenue was consulted regarding this tax benefit, but there is a doubt regarding the facts, that is, whether Government wanted to give some additional benefits or benefits as were available under the Act itself... Now if there was a clear intention at that time by the Government to give concessions which were, in fact, given later on, then Central Board of Revenue should have pointed out that these were outside the scope of the Act and therefore, were not admissible. But this was not done and there is some doubt, so far as the noting in the file goes, whether the Government intended at that time to give benefits going outside the scope of the Act. Now when the case started, the Income-tax

Officer referred the first case, which was regarding whether development rebate should be given to the machinery which was installed prior to the formation of the Oil India company. The Income-tax Officer referred the matter to the Commissioner and the Commissioner seems to have sent a communication to the Board. But, he did not ask for a specific decision of the Board whether concession should be given or not, in terms either of the Income-tax Act or in terms of the agreement. He also did not point out that this was outside the scope of the Act. But he sent a communication to the Board and there, I would agree that the Board should have got that matter examined and should have found out whether that was permissible or not. That was not done and the Income-tax Officer gave the benefit under instructions from the Commissioner. The second question arose, to which you are referring now, when the company again asked for benefit of development rebate on casings and tubings. This was another thing and the matter was referred to the Board. So far as the benefit of depreciation and development rebate, in regard to casings and tubings is concerned, the matter was examined in consultation with the Ministry of Law and the Board gave the view that development rebate was admissible in the case of tubings and casings."

3.26. The Ministry in a further note stated:

As regards the question whether amortisation allowance was also allowed in respect of plant and machinery on which development rebate/depreciation allowance was also allowed to Oil India Limited, the position as reflected by the Board's file No. 3(2)|61-IT(AI) and file No. 10|70|64-IT(AI) is as follows:

"The expenditure in respect of which an allowance of Rs. 61 lakhs per annum for a period of 15 years from the assessment year 1963-64 was given in terms of clause 12(iii) of the Second Supplemental Agreement amounted to Rs. 916.56 lakhs which comprised the following items:

Geological and geophysical expenditure		Rs. 153·54	lakhs.
Servicing wells and test production cost of oil wells . .		Rs. 32·49	lakhs.
Drilling cost	Rs. 620·30	Rs. 727·50	lakhs.
Casing & Tubing	Rs. 107·20		
Preliminary expenses and consultant's fee		Rs. 3·03	lakhs.
		Rs. 916·56	lakhs.

$$\frac{\text{Rs. 916·56 lakhs}}{\text{15 years}} = \text{Rs. 61 lakhs per annum amortisation allowance.}$$

It will be seen from the above that a sum of Rs. 107.20 lakhs representing the cost of 'casing and tubing' was included in the expenditure of Rs. 916.56 lakhs which was allowed to be amortised over a period of 15 years. Development rebate amounting to Rs. 26,79.904 was also allowed on Rs. 107.20 lakhs representing the cost of 'casting and tubing' pursuant to the instructions issued by the Board referred to above."

3.27. The Committee enquired whether the assessee originally claimed that the items for which amortisation allowance was allowed were not depreciable assets. If so, the Committee wanted to know the stage at which the assessee went back on this claim. The Ministry, in a note, stated: "The company in its letter dated 29-4-1964 to the Income-tax Officer took the stand that casing and tubing constitute plant and machinery on which development rebate is admissible. However, the non-depreciable items for the purposes of arriving at the annual amortisation allowance of Rs. 61 lakhs referred to in clause 12(iii) of the Second Supplemental Agreement includes casing and tubing of the value of Rs. 107.20 lakhs. This seems to indicate that at the time of concluding the agreement, the company thought that casing and tubing were to be regarded as non-depreciable items weheras at the time of assessment it took the stand that they constituted plant and machinery on which development rebate was admissible."

3.28. Audit have brought out the following points:

(i) According to the agreement, depreciation allowance and development rebate was to be allowed in accordance with the Income-tax Act. The Act allows development rebate only in respect of new plant and machinery installed in the relevant previous year, owned by the assessee and wholly used for the purpose of his business. It is clear from the history of the case, recounted above, that the plant and machinery taken over from the Assam Oil Co., were not new and were also not installed in the relevant previous year. The year-wise details of the expenditure on their installation are not known but from the fact that oil was first struck in 1953, it is clear that a substantial portion thereof must have been installed even before 1954 when the provision for development rebate become effective in the Income-tax Act. The grant of this development rebate on both plant and machinery and on casing and tubing is therefore an extra legal concession.

(ii) In respect of the assets installed between 1954 and 1958, the Assam Oil Company itself had claimed development rebate in its assessments. It remains to be confirmed whether such claims had been allowed also in respect of assets subsequently transferred to Oil India and admitted for development rebate in 1960-61 as aforesaid. The Department has not noted that development rebate was not allowed earlier.

(iii) In respect of the expenditure on casing and tubing the CIT had first given a view that casing and tubing was not plant and machinery and hence no development rebate would, in any case, be admissible thereon. (In the second Supplemental Agreement also as aforesaid, this expenditure was included not under plant and machinery but under the amortisable expenditure). Subsequently on the basis of a local inspection, the Commissioner veered round to the view that casing and tubing constitute parts of the composite unit of as oil well and the oil well, as such, is plant and machienry. At this stage, however, he pointed out that in respect of the expenditure of Rs. 107.20 lakhs on casing and tubing, if development rebate were to be allowed a corresponding reduction would have to be made in the amortisation expenditure of Rs. 916.56 lakhs. In fact, Oil India Ltd., also expressed the view in August, 1964 that in the event of depreciation and development rebate being separately allowed on this expenditure of Rs. 107.20 lakhs a corresponding reduction may be made in the amortisation allowance. Nevertheless, the Board came to the aforesaid decision that development rebate on this expenditure may be allowed without making any reduction in the amortisation allowance.

(iv) Under the Income-tax Act as quoted above, a provision for amortisation of expenditure on drilling or exploration activities of expenditure could be made by agreement only if such expenditure were 'expenditure incurred by the assessee'. In the present case the expenditure of Rs. 916.56 lakhs for which amortisation over a period of 15 years had been provided in the Second Supplemental Agreement is not expenditure incurred by the assessee *viz.*, Oil India. It was incurred by Assam Oil Co. The allowance of Rs. 61 lakhs per annum being allowed for a period of 15 years from the assessment year 1963-64 also therefore constitutes an extra legal concession, the assessee *i.e.*, Oil

India was not even in existence when this expenditure was incurred by the Assam Oil Company.

3.29. The Committee pointed out that it was learnt that an indirect consideration was passed to Assam Oil Company for a period of 20 years by Oil India by way of supply of oil and associated natural gas at a concessional rate ranging between 50 to 60 per cent of the normal sale price in consideration for furnishing geological ad geophysical data and other technical services and that it was not clear whether the entire assets of Assam Oil Company had been taken over on the basis of market value.

3.30. When enquired whether this was done with a view to avoid capital gains tax, the Finance Secretary stated: "This point will have to be examined in the Petroleum and Chemicals Ministry because they have entered into this agrement. I am concerned only with tax part."

3.31. The Ministry, in a note, added: "Ministry of Petroleum and Chemicals has been requested to furnish a detailed note indicating the factual position. Further reply will follow after the matter has been examined in consultation with the Ministry of Law."

3.32. M/s. Oil India Ltd., a joint venture of Government of India and Burmah Oil Company incorporated on 18th February, 1959, took over the assets of Assam Oil Company Ltd., a subsidiary of Burmah Oil Company. The Committee are not happy over the manner in which tax concessions have been granted purported to be in accordance with an agreement dated 27th July, 1961, to M/s. Oil India Ltd., the benefit of which partly went to a foreign multinational Corporation which is against national interest. It is evident that the implications of the various provisions of this agreement in relation to taxation had not been carefully and properly scrutinised before they were finalised. The following points arise out of the Committee's examination of the matter.

(i) The agreement provided that in respect of the expenditure of Rs. 916.56 lakhs on certain assets taken over by M/s. Oil India Ltd., amortisation over a period of 15 years at the rate of Rs. 61 lakhs per annum would be allowed from the assessment year 1963-64 onwards. This was purported to be done under Section 42 of the Income-tax Act, 1961. Under this Section a provision for

amortisation of expenditure on drilling or exploration activities could be made by agreement only if such expenditure were "expenditure incurred by the assessee". It was, however, not the case here and therefore the allowance would constitute an extra legal concession resulting in huge loss of revenue.

(ii) In terms of the agreement, in respect of the expenditure (Rs. 161.04 lakhs) on building, plant and machinery "usual depreciation/development rebate" should be allowed each year per the income-tax Act. Under this provision the company was allowed development rebate on the pre-incorporation expenditure on building and machinery to the extent of Rs. 33.04 lakhs for the assessment year 1960-61 by the ITO under instructions from the Commissioner. Under the Income-tax Act, however, the grant of development rebate is subject to the condition that the plant and machinery should be new and that it is admissible only in respect of the year of installation. The Committee were niformed that there was no intention of giving any development rebate in relaxation of the basic provision of the law. The plant and machinery taken over from the Assam Oil Co., were not new and were also not installed in the relevant previous year (1959-60). It seems that substantial portion thereof must have been installed even priod to 1954 when the provision for development rebate became effective in the Income-tax Act. Further, it remains to be confirmed whether in respect of assets installed between 1954—58, the Assam Oil Co. itself was allowed development rebate in its assessment. Although the Board was associated with the drafting of the relevant clauses of the agreement relating to taxation, it was not pointed out that this concession was outside the scope of the Act which, as felt by the Finance Secretary, should have been done. Further, it is unfortunate that even when the Commissioner made a reference to the Board, the oBard did not examine the matter properly and find out whether the development rebate on these assets were admissible to M/s. Oil India Ltd. Only now is it proposed to consult the Ministry of Law in the matter. There does not appear to have been any justification for allowing such extraordinary and extra legel concessions.

(iii) In addition to the development rebate on plant and machinery, a sum of Rs. 26.80 lakhs was also allowed as development rebate on "casing and tubing", costing Rs. 107.20

lakhs in the assessment year 1960-61. This cost was, however, included in the expenditure of Rs. 916.56 lakhs which was allowed to be amortised over a period of 15 years. Although a view was initially held that "casing and tubing" was not plant and machinery and hence no development rebate would, in any case, be admissible thereon, it was allowed under the instructions of the Board without making any reduction in the amortisation allowance. Even if it is regarded as plant and machinery it is doubtful whether development rebate would be admissible in view of what is stated in item (ii) above. The Ministry of Finance have promised to take up the matter again with the Ministry of Law.

(iv) An indirect consideration was passed on to Assam Oil Co., for a period of 20 years by Oil India Ltd., by way of supply of oil and associated natural gas at a concessional rate ranging between 50 per cent to 60 per cent of the normal sale price. The Committee understand that the benefit of this concession is estimated at Rs. 9 crores. It is not clear whether the entire assets of Asam Oil Company had been taken over on the basis of the market value. It should, therefore, be examined from the angle of capital gains tax, in consultation with the Ministry of Petroleum and Chemicals and Ministry of Law, whether in view of the substantial concession there wa under-valuation of the assets.

3.33. In view of the fact that the quantum of concessions is very large and it is not free from doubt to what extent they were given by Government as a matter of policy or to what extent they are in accordance with the law, the Committee consider it essential that there should be a thorough enquiry into the matter immediately for appropriate action including revision of the relevant assessments of the company to the extent that is legally permissible. Responsibility for the failure/lapse of the C B D T as brought out in items (ii) and (iii) should also be fixed for such action as may be called for.

3.84. The Board should also have an effective machinery for proper scrutiny of the taxation aspects of such agreements before they are finally entered into by the Government of India.

Audit Paragraph

3.35. Under the Income-tax Act, an assessee who avails himself of the concession of development rebate should keep 75 per cent of

the development rebate in a separate reserve account and should not utilise the same for distribution as dividends or for remittance outside India as profits for a pperiod of eight years. If this directon is not followed the development debate already granted, should be withdrawn.

3.36. Company 'A' was allowed development rebate for the assessment years 1959-60 to 1967-68 and 1969-70. Another company 'B' was allowed development rebate for the assessment years 1967-68 and 1968-69. But the development rebate reserves created by them for the relevant years were transferred within eight years to general reserves and utilised either for distribution of dividends or issue of bonus shares or for setting-off against debit balance of the Profit and Loss accounts. The development rebate reserves having thus been utilised for prohibited purposes within the prescribed period of eight years, the development rebate originally given should have been withdrawn and charged to tax in the respective assessment years in which it was allowed.

3.37. This having not been done, there had been an under-charge of tax amounting to Rs. 5,04,102 for the assessment years 1959-60 to 1966-67 and also an excess computation of business loss of Rs. 2,72,105 for the assesment year 1967-68 and 1969-70 in repect of company 'A'. In the case of company 'B', tax was undercharged by Rs. 3,77,394 for the assessment year 1967-68 and business loss was excess calculated by Rs. 3,58,487 for the assessment year 1968-69.

3.38. The Ministry have replied (January, 1973) that the assessment in respect of ompany 'B' has been revised and the additional demand raised. Regarding company 'A' report of rectification of the mistake is awaited.

[Paragraph 18(iv) of the Report of the Comptroller and Auditor General of India for the year 1971-72, Union Government (Civil), Revenue Receipts, Volume II—Direct Taxes].

3.39. The Committee enquired whether the provisions of the Act, regarding withdrawal of development rebate on violation of the conditions stipulated for the utilisation of development rebate reserve were not clear. If the instructions were clear, the Committee asked how it was that the Income-tax Officers failed to notice the transfer of the Development Reserve when they finalised subsequent year's assessments. The Ministry of Finance (Department of Revenue and Insurance) in a note furnished to the Committee,

stated: "The provisions of the Act regarding withdrawal of Development Rebate for violation of the conditions stipulated are clear.

3.40. Mistake which was committed by three ITOs occurred in this case because the ITOs failed to notice the fact that Development Rebate Reserve had been utilised for declaration of dividend or having noticed this fact failed to draw the necessary legal conclusions. There has been a human failure in this case".

3.41. The Committee were given to understand by Audit that in the former case (Company 'A'), the rectification of assessments for the Assessment Years 1959-60 to 1966-67 could not be done as this had become time-barred; the under-charge of Rs. 5,04,102 for these assessment years was thus a loss of revenue to Government. The assessments for 1967-68 and 1969-70 were reported to have been rectified, thereby reducing the assessed loss by Rs. 87,118 and Rs. 1,90,987 respectively.

3.42. Referring to the loss of revenue of Rs. 5,04,102 for the assessment years 1959-60 to 1966-67, the Committee enquired whether the Ministry proposed any action against the officers responsible for this big loss of revenue and whether the Ministry took any action to avoid such losses in future. The Ministry, in a note, stated: "In the case of S/Shri.... and ....., their explanations were found to be not acceptable and they were informed accordingly. In the case of Shri ....., the CIT was asked to have a general review of important cases handled by this officer so as to detect any serious mistakes made in other cases. The C.I.T. has reported that important asessment made by the officer have been mostly subjected to Revenue/Internal Audit and a general review made by the IAC on the basis of random checking has not revealed any serious defect. Nevertheless, so far as this particular case is concerned, the officer had been informed that his explanation was not found acceptable.

Instructions have been issued for taking prompt action in cases of this nature. The introduction of immediate audit would also ensure that Internal Audit Parties would check such important cases within one month of the completion of assessment."

3.43. The Committee learnt from Audit that in the latter case (Company 'B'), the assessments for both the years were reported to have been rectified under Section 154 and an additional demand of

Rs. 3,77,394 raised. The rectificatory orders for these two assessments years were, however, stated to have been cancelled by the Appellate Assistant Commissioner, against whose decision, the Department were stated to be going in appeal before the Appellate Tribunal.

3.44. According to Audit, for rectification of such cases there is a specific provision in Section 155(5) and it is elementary that section 154 has no application.

3.45. The Committee enquired whether Section 154 was the proper Section to resort to cases of this type. They also wanted to know the reasons given by the Appellate Assistant Commissioner for cancelling the order and the result of further appeal to Appellate Tribunal. The Ministry, in a note, stated: "Under Section 155 (5), when the Development Rebate Reserve has been utilised for a prohibited purpose, the Development Rebate for the relevant year is to be deemed to have been wrongly allowed and this mistake could be rectified under section 154.

The only other Section under which the mistake could have been corrected is Section 263 but action under this Section had become time-barred when the Revenue Audit report was received. Action for 1969-70 in the case of ..... could also not be taken because the relevant assessment had become a subject matter of appeal before the AAC.

The dividend in these cases has been declared out of a composite Fund consisting of the General Reserve, the Development Rebate Reserve and the Development Reserve. The dividend declared is less than amount of the General Reserve. Therefore, in the case of M/s ..... the AAC had held that the dividend could be deemed to have been declared out of the General Reserve and not out of the Development Rebate Reserve. He also held that in any case, since the matter was arguable, Section 154 did not apply.

The departmental appeal before the Tribunal is pending."

3.46. The Committee desired to know whether both these companies were Public Limited Companies i.e., companies in which public were substantially interested and whether any foreign company had any holding of shares in these companies. The Ministry,

in a note, stated: "Both are Public Limited Companies. The non-resident share holding is as below:

	Ordinary		Preference	
	No. of non-resident share-holders	No. of shares	No. of non-resident shareholders	No. of shares
Indian Standard Wagon.	16	32,535 *(1559400)	11	730 (19665)**
Burn & Co.	18	6,630 **(336000)	12	651 (28000)**

(Figures in brackets give total No. of shares)

It was understood from Audit that one of the assessments was checked by Internal Audit of the Department, but mistake was not noticed by them. Rest of the assessments were not checked by Internal Audit at all. The Committee enquired whether the Board had not issued instructions in 1965 itself that all company assessments should be checked cent per cent by Internal Audit. They also asked how it was that the assessment for eight years—in case 'A' and for two years in case of 'B'—were left unchecked by the Internal Audit. The Ministry, in a note, stated: "The strength of the Internal Audit Parties was not adequate to complete the volume of work within a reasonable time. Consequently, some cases could not be checked by Internal Audit Parties."

3.47. The Committee desired to know whether there were any checks to see whether Internal Audit Parties adhered to the programme of audit both as regards coverage and periodicity as prescribed. The Ministry, in a note, stated: "Due to limited manpower available for the internal audit organisation of the Department, priorities have been laid down for their work so that cases with considerable revenue effect get foremost attention. These priorities have been indicated in the Ministry's reply to para 3.4 of the Public Accounts Committee's 88th Report (1972-73). For the top priority cases 'immediate' audit has been prescribed since 1972 requiring these cases to be audited within one month of completion of assessment. In 1972 certain administrative steps were also take for improved performance viz. (i) the number of I.A.Ps. was increased from 91 to 121; (ii) a cadre of ITOs (Internal Audit) was created to supervise Internal Audit Parties and ensure their proper functioning according to the guidelines laid down; (iii) the number of

*Face value Rs. 10/- each.

**Face value Rs. 100/- each.

I.A.Cs. (Audit) was also increased for providing better second level control; (iv) at headquarters an Audit Cell under a Deputy Director (assisted by an Assistant Director and staff) was also added in the Directorate of Income-tax and Audit for effective coordination of internal audit functioning."

3.48. Under the Income-tax Act, an assessee who avails himself of the concession of development rebate should keep 75 per cent of the development rebate in a separate reserve account and should not utilise the same for distribution as dividends of for remittance outside India as profits for a period of 8 years. If this direction is not followed the development rebate already granted, is liable to be withdrawn. The Committee note with concern that in the case of a number of assessments relating to two companies the ITO did not take any notice of the fact that the development rebate reserve had been utilised for declaration of dividend or having noticed the fact, failed to take necessary action open to him.. This failure resulted in a short-levy of tax to the extent of Rs. 8.81 lakhs, and excess computation of business loss of Rs. 6.31 lakhs... The Committee find that in these companies the non-resident share-holding is substantial. They further find with concern that a recovery of under-charge of Rs. 5.04 lakhs from one of the companies has become time-barred. They cannot but take a serious view of the substantial loss to Government. Surprisingly, no action seems to have been taken against the ITOs concerned excepting that they were informed that their explanations were found to be not acceptable.

3.49. As no extenuating circumstances appear to exist, the Committee consider that appropriate disciplinary action should be taken against them and the Committee informed.

3.50. It is most distressing that the assessments for 8 years in the case of one company and for two years in the case of another company were not checked by Internal Audit despite instructions issued by the Board in 1965 that all company assessments should be checked cent-per-cent. The check of the only assessment carried out by them did not bring to light the mistakes. This yet another instance of the inefficiency and inadequacy of the Internal Audit. The Committee are unable to accept the plea that the strength of the Internal Audit parties was not adequate to complete the volume of work within a reasonable time. What is necessary is the manning of Internal Audit Parties with competent and trained personnel at a fairly high level. The Committee would like this aspect to be examined urgently and suitable action taken thereafter without loss of

time. Meantime, the Committee note that recently the Board have laid down priorities for the work of the Internal Audit so that cases with considerable revenue effect get foremost attention and trust that the Board will ensure that at least these instructions are strictly adhered to by the Internal Audit.

3.51. The Committee would await the outcome of the departmental appeal before the tribunal in the case of one of the companies.

Audit Paragraph

3.52. According to the provisions, of the income-tax Act, the actual cost of any asset acquired by the amount of the enhanced liability that had accrued on account of devaluation of rupee. However, the grant of development rebate on such increased liability was specifically prohibited.

In the assessments of three companies for 1967-68, the department, however, allowed development rebate on the increase in cost of assets of plant and machinery consequent on the change in the exchange rate. This resulted in the grant of excess of development rebate in the three cases aggregating Rs. 5,99,166 in the assessment year 1967-68, with consequential under-charge of tax by Rs. 2,83,637 in two cases and excess carry-forward of unabsorbed development rebate by Rs. 83,462 in the third case.

3.53. The Ministry have replied (January, 1973) that the assessments have been revised and additional demand raised. Report regarding collection of the demand is awaited.

[Paragraph 18(v) of the Report of the Comptroller and Auditor General of India for the year 1971-72, Union Government (Civil), Revenue Receipts, Volume II-Direct Taxes].

3.54. Sub-section (1) of Section 43A of the Income-tax Act provides that where a part of payment towards the cost of assets purchased in foreign countries is yet to be made and the liability on account of such outstanding payments goes up due to devaluation of the Indian currency, the assessee can write up the cost of such assets in his books for purposes of claiming depreciation etc. However, sub-section (2) of the same section specifically prohibits allowance of development rebate on the increase in cost of assets on account of devaluation. Nevertheless, in the cases of three companies, assessed in the C-Ward of Company District I, Calcutta, excess

development rebate was allowed due to non-observance of the specific provision. The details of the cases are as under:

	Name of the Company	Amount of Development Rebate irregularly allowed	Tax undercharged
		R.	Rs.
1.	M/s (A)	4,90,818	2,69,950
2.	M/s (B)	24,886	13,687
3	M/s (C)	83,462	Unabsorbed development rebate of Rs. 83462 was carried forward a subsequent yer

3.55. The Committee were given to understand by Audit that the Ministry had accepted the mistake in all the three cases and the assessments in the first two cases had been rectified and additional demand raised.

3.56. The Committee wanted to know whether the assessment in the third case had been rectified and the additional demand raised. The Ministry of Finance (Department of Revenue and Insurance), in a note submitted to the Committee, stated: "The assessment in the third case has been rectified. This has resulted in the reduction of loss to be carried forward and therefore the question of collection of the taxes does not arise."

3.57. When asked whether the additional demand raised in the two cases, had since been realised, the Ministry, in a note, stated: "The additional demand raised in (B) has been collected. Being a loss case, there is no demand to be collected in the case of (C)."

3.58. The Committee learnt from Audit that assessments in two out of three cases were checked by Internal Audit. The Committee wanted to know the circumstances in which the mistake escaped their notice. The Ministry stated: "The instructions to the Internal Audit Parties were that in cases of depreciation and development rebate of over Rs. 25,000 calculations would be checked by an Income-tax Officer posted as OSD. Therefore, Internal Audit Parties were not expected to check development rebate calculations.

The officer could not check these cases as during the relevant period he had heavy workload of about 26,000 cases for checking."

3.59. The Committee pointed out that the assessments were completed in Company Districts where generally more experienced I.T.Os. were posted and asked how then the mistake was committed by both the I.T.Os. who made the assessments. They also enquired whether any explanations had been obtained from the IT.Os. and whether the Ministry had verified whether there were any other similar mistakes in the same circle. The Ministry, in a written note stated: "The mistake has been committed by 2 ITOs because they did not either notice the fact that additions to machinery included increase in the cost due to devaluation or having noticed this fact they over-looked the express provisions of section 43(A)(2).

These two cases were handled by Shri 'B' and Shri 'C'. The explanations of these officers were obtained. They have stated that the mistake was due to oversight and is regretted.

In the case of Shri...., serious mistakes have been noticed in a few other cases also handled by him in the Companies Circle, Calcutta. The CIT was asked to shift the officer to an unimportant assignment. He has consequently been shifted to a comparatively minor charge. The CIT was also asked to have this officer's work in the Companies Circle inspected by the IAC; the inspection report is awaited. Having regard to the totality of the mistakes noticed, suspension orders were passed in this officer's case on 22nd August, 1973 and the officer was actually suspended w.e.f. 25th August, 1973. However, for certain reasons the suspension order was revoked. Before the suspension order was passed, the matter was referred to the CBI. The CBI have accordingly registered a case against the officer and taken up investigation. On receipt of the CBI's report, the question of further action against the officer will be considered.

In the case of Shri ..... also, a few other serious mistakes were noticed. Apart from issuing warnings to the officer in some of the cases the CIT has been asked to have the officer's work as ITO, Companies Circle, inspected. The D.I.(II) was also asked to inspect the officer's work as A.A.C. The DI(II)'s inspection report on the officer's work as AAC has been received and is satisfactory. The CII's inspection report on the officer's work as ITO Companies Circle, is awaited. Action to suspend this officer had also been contemplated, but due to certain reasons was not carried through. However, this officer's case has also been referred to the CBI who are investigating the matter. On receipt of their report the question of further action will be considered."

3.60. The Committee wanted to know whether the assessee Companies had themselves claimed the Development Rebate on the increased cost of the machinery and whether the Income-tax Act prescribed any penalty for such irregular claim. The Ministry, in a note, stated: "(A) and (C) had claimed development rebate on the increased cost of machinery.

Since the revision of assessment was done u/s 154, no penalty proceedings were initiated. The Commissioner has been instructed to examine the question of prosecution in consultation with the Standing Counsel."

3.61. Sub-section (1) of Section 43A of the Income-tax Act provides that where a part of payment towards the cost of assets purchased in foreign countries is yet to be made and the liability on account of such outstanding payments goes up due to devaluation of the Indian currency, the assessee can write up the cost on such assets in his books for purposes of claiming depreciation etc. However, sub-section (2) specifically prohibits allowance of development rebate on the increase in cost of assets on account of devaluation. Nevertheless, in the cases of no less than three companies excess development rebate was allowed due to non-observance of this provision. The Committee regret that mistakes (if they were mistakes at all) of this type should have occurred in a Company Circle where the ITOs handled assessments of a few important companies only. The Committee learn that the cases of the two officers who handled these assessments have been referred to the CBI for investigation. They desire that the investigation should be carried out with all speed and the results as well as the action taken against the officers reported to them.

3.62. The Committee further find that the two companies had claimed development rebate on the increased cost of machinery due to devaluation and that as the revision of the assessment was done under Section 154 no penalty proceedings were initiated. The Committee desire that the question of prosecution should be examined expeditiously and the action taken intimated to them.

3.63. The Committee have received an impression that the cases of depreciation and development rebate allowed by the ITOs are not being checked properly despite the instructions issued by the Board from time to time. In this connection they would refer to their observation contained in paragraph 2.148 of their 51st Report regarding carrying out of a check of such cases by the IAC's. Further, although the instructions to the Internal Audit Party were that in cases of depreciation and development rebate of over Rs. 25,000, calculations would be checked by an ITO posted

as Officer-on-Special Duty, the cases mentioned in the Audit paragraph had not been checked by him. The plea of heavy work-load is totally unacceptable as it was upto the Government to see that proper arrangements are made so as to ensure effective compliance of their instructions. The Government should carefully assess the work-load keeping in mind the quality aspect of the work-load and take steps to have adequate staff. The Committee expect Government to see to it that their instructions are enforced efficiently and expeditiously.

Audit Paragraph j

3.64. The Income-tax Act, 1961, as also the Rules framed thereunder provide for the grant of normal and an additional depreciation called extra-shift allowance in respect of the plant and machinery working more than one shift. For double-shift working, the extra-shift allowance is subject to the maximum of 50 per cent of the normal depreciation calculated with reference to the actual number of days for which the concern worked double-shift. For triple-shift working, however, the extra-shift allowance is subject to the overall limit of 100 per cent, including 50 per cent for double-shift working of the normal depreciation.

3.65. For the assessment year 1966-67, the department granted to a company Rs. 2,50,801 as normal depreciation, on certain items of machinery, as also Rs. 1,25,401 and Rs. 2,50,801 for double and triple-shift working respectively. The total extra-shift allowance exceeded the prescribed ceiling of 100 per cent of the normal depreciation by Rs. 1,25,401 which led to a tax undercharge of Rs. 68,871.

3.66. In another case, for the assessment year 1964-65, extra-shift allowance on machinery for double-shift working was granted at 100 per cent of normal depreciation instead of at the admissible rate of 50 per cent. This resulted in excess extra-shift allowance of Rs. 2,04,017 with consequential tax under-charge of Rs. 1,02,008.

3.67. In respect of the same assessee for the assessment year 1966-67, a net excess allowance of Rs. 29,632 was granted and thus, in respect of these two assessments there was a short levy of tax of Rs. 1,18,306.

3.68. The Ministry have replied (January, 1973) that the mistakes in the above cases have been rectified and that the additional demand totalling Rs. 1,87,277 raised.

[Paragraph 18(vi) of the report of the Comptroller and Auditor General of India for the year 1971-72, Union Government (Civil), Revenue Receipts, Volume II—Direct Taxes].

3.69. The Committee enquired whether the additional demand raised had since been collected. The Ministry of Finance (Department of Revenue and Insurance), in a note submitted to the Committee, stated: "In .... (A) Ltd. the demands have been stayed as the assessments of earlier years, where losses have been returned, have been set aside by the AAC and the re-assessments are yet to be completed. These assessments require investigation of a large number of cash credits and hence the delay in completing them.

.... (B) Ltd., has challenged the rectification in a writ before the Calcutta High Court. Since the High Court has granted an injunction, the Demand Notice could not be served in that case."

3.70. To a question, the Ministry, in a note, stated that the rules regarding extra shift allowance are quite clear and that these had been further elucidated in Board's circular No. 199 dated 20th March, 1973.

3.71. When asked whether the cases had been investigated thoroughly, the Ministry, in a note, replied that the mistakes appeared to have occurred due to human failure.

3.72. The Committee desired to know whether other assessments of these assessees and other companies in the same Circle had been checked to see whether the extra shift allowance was wrongly claimed and allowed for other years. The Ministry, in a note, stated: "A review has been conducted to verify whether similar mistakes have been committed in other assessments in these two cases.

In (A) Mills, similar mistakes were committed in 1967-68, 1968-69, 1969-70 and 1965-66. The assessment for 1967-68 has been rectified. Before the other assessment could be rectified, the records were requisitioned by the Board for scrutiny and preparation of brief for the PAC. The rectifications will be carried out as soon as the records are returned.

In (B) Mills Ltd., no mistake has been noticed in any other year.

A test check of the assessments made by ITO did not disclose any mistake in any other case.

A report on the results of the review of the work of Shri Sharan who committed the mistake in (B) Ltd. is awaited."

3.73. The Audit paragraph brings out incorrect computation of the extra shift allowance for double and triple shift working of

plant and machinery in the cases of two companies. Under the Rules 50 per cent of the normal depreciation is allowed for each of the double and triple shifts. Very strangely, however, in the case of one company extra shift allowance at 100 per cent of the normal depreciation was allowed for the triple shift working of the machinery in addition to extra shift allowance @ 50 per cent for the double shift. In the case of another company, extra shift allowance for the double shift working was allowed at 100 per cent of the normal depreciation instead of at 50 per cent. These serious lapses accounted for an under-charge of tax of Rs. 1.71 lakhs. The Committee are unable to understand how, when the Income-tax Rules are abundantly clear, the assessee company could claim extra shift allowance of more than 100 per cent of normal allowance and how the ITOs could allow such claims. The facts are such as to indicate that the mistakes are not bona-fide. The matter requires thorough investigation by the Board and the Committee trust that strict disciplinary action will be taken thereafter.

3.74. The Committee find that review conducted by the Department revealed similar lapses in as many as 4 other assessments relating to one of the companies. A review of all company assessments made by the ITOs concerned is called for. And if it shows that similar mistakes have been committed in other cases also, the matter should be refered to the CBI for further investigation.

CHAPTER IV

IRREGULAR EXEMPTIONS OR EXCESS RELIEFS GIVEN

Audit Paragraph

4.. (i) In para 50(b) of the Audit Report on Revenue Receipt 1970-71, it was pointed out that the department allowed concessional tax admissible to industries set up in the priority sector in respect of radio receivers, loudspeakers and radio parts, deeming them incorrectly to fall under the category of 'electrical communication equipment' mentioned in the Schedule VI of the Income-tax Act. In the following two cases, similar mistake was noticed while conducting audit early in 1972.

(a) The Tax concession meant for priority industries was given to a company manufacturing resins and fabrication of water-treatment equipment which are not listed as the priority industries. The Ministry, after consulting the Ministry of Industrial Development, have accepted the Audit objection and have stated that the department would be taking necessary rectificatory action.

(b) In another case, a company deriving income from manufacture of radio receivers was incorrectly allowed the tax rebate available to the priority industries for the assessment years 1966-67 and 1967-68 resulting in short-levy of tax of Rs. 2,30,758.

4.2. In this case also, the Ministry have accepted the audit objection and reported that the mistake has been rectified. Report regarding recovery of the tax is awaited.

[Paragraph 19(i) of the report of the Comptroller and Auditor General of India for the year 1971-72, Union Government (Civil), Revenue Receipts, Volume II—Direct Taxes].

4.3. The Committee asked when the relevant schedule in the Act did not list out such manufactures, as mentioned in the Audit para, whether it was not the responsibility of the assessing officers to consult their higher authorities to ascertain the actual position instead of finalising the assessments or more presumptions. The Department of Revenue and Insurance, in a note submitted to the Com-

mittee, stated: "The Income-tax Officer making the assessment has to take decisions on the various issues arising in the proceedings before finalising the assessment. If he has a doubt on any particular issue(s), he can seek guidance from the higher authorities; otherwise he is legally competent to dispose of the matter according to his understanding of law and appreciation of facts.

4.4. As regards para 19(i)(a) it may be mentioned that the assessee manufactures Water Treatment Plants. The Audit objection was initially accepted on the opinion given by the Ministry of Industrial Development. On further factual details reported by the Additional Commissioner of Income-tax, the issue was re-examined in consultation with the Ministry of Heavy Industries. They have confirmed that the Water Treatment Plants manufactured by the company are to be treated as Chemical Machinery covered by Schedule Industry No. 8-A(9) under IDRA but the resins manufactured by the company are not an integral part of the Water Treatment Plant. Therefore, the profits derived by the company from manufacture of the mechanical portion of the Water Treatment Plant is entitled to tax concessions applicable to priority industries but the profits from the manufacture of resin is not entitled to such concession. The above facts have been communicated to the Audit vide letter dated 10th November, 1973 and Audit's concurrence in the above interpretation is awaited.

Regarding para 19(i)(b) it may be pointed out that the relevant Schedule listed not only Electronic Equipment but also Electronic Communication Equipment. The Department of Electronics had advised the Board that radio receivers are to be classified as 'telecommunication equipment' and not as 'electronic equipment'. Later the Department of Electronics had mentioned that communication equipments are becoming increasingly electronic in nature. The Income-tax Officer and the Appellate Assistant Commissioner of Income-tax have been apprised of the Electronics Department's opinion; the decision of AAC is awaited, the assessee having also submitted before him opinion from a private expert in this line."

4.5. As regards the present stage of the case, the Ministry stated: "The A.A.C. was requested to take up the appeals out of turn. The A.A.C. has called for certain information from the I.T.O. including a copy of the opinion of the Department of Electronics. This has been sent by the Board to the Commissioner of Income-tax. A.A.C.'s decision is awaited."

4.6. The Committee wanted to know whether the assessments mentioned in the audit paragraph 19(i)(a) had been revised and

additional tax recovered from the Company. The Ministry, in a note stated: "Audit Para 19(i)(a): The assessment for 1970-71 has been revised by the Additional Commissioner of Income-tax under Section 263 and the additional demand has been collected. The company has filed an appeal before the Income Tax Appellate Tribunal."

4.7. It is understood from Audit that the additional demand raised in this was for Rs. 79,207.

4.8. According to the Audit paragraph two companies derived income from the manufacture of (a) resins and fabrication of water-treatment equipment and (b) radio-receivers respectively. These were treated as priority industries, even though the relevant schedule in the Act did not mention them. According to Audit such treatment was irregular and resulted in short-levy of tax to the extent of Rs. 3.10 lakhs. The Committee, however, find that as regards (a) although the Audit objection was initially accepted on the opinion given by the Ministry of Industrial Development, the issue had been re-examined. Accordingly it is felt that profits derived by the company from manufacturer of the mechanical protion of the water treatment plant is entitled to tax concessions applicable to priority industries but the profits from the manufacture of resin is not entitled to such concession and that the matter has been referred to Audit. As regards (b) although the Department of Electronics had earlier advised the Board that radio-receivers are to be classified as 'tele-communication equipment', they had later mentioned that communication equipments are becoming increasingly electronic in nature. In the meanwhile, the lapses pointed out by Audit had been rectified and the assessees had gone in appeal. The Committee would await the outcome of the appeals.

4.9. The Committee regret the delay in ascertaining the correct position in regard to these cases. They desire that such question should be examined very expeditiously with a view to the officers in the field being apprised of the correct position at the earliest possible date. This was emphasised earlier in paragraph 2.171 of the 87th Report (Fifth Lok Sabha), which, it seems, has not been given enough attention to. After ascertaining the correct position in the cases in question, it is also necessary to undertake a general review to see whether assessments involving such industries were properly made.

Audit Paragraph

4.10. With a view to providing incentives for exports, the Income-

tax Act and the Finance Acts provide the following reliefs:

(1) a rebate of 1/10th of the average rate of income-tax on the profits made by an assessee out of such exports;

(2) a rebate at the average rate of income-tax on 2 per cent of the sale proceeds manufactured by an assessee which were exported by him direct or through an exporter;

(3) with effect from 1st April, 1968 domestic companies in India which incur any expenditure under specified heads to promote sales outside India, are allowed an 'export-market development allowance' of an amount equal to 1 1/3 time the amount of qualifying expenditure.

4.11. The Finance (No. 2) Act, 1967 provided that the rebates of tax mentioned at items (1) and (2) above should be in respect of exports of goods prior to 6th June, 1966.

4.12. A company claimed tax relief for the assessment year 1967-68 on export sales and profit with reference to figure of sales which included cash subsidy and excise drawbacks amounting to Rs. 19,39,592 and Rs. 9,13,239 respectively. While allowing tax relief to the assessee, the department omitted to exclude the sum of Rs. 19,39,592 and Rs. 9,13,239 included in the sales and allowed rebate on the value of sales enhanced in this manner. This resulted in the grant of excess rebate of tax to the extent of Rs. 39,255.

4.13. The Ministry have replied (December, 1972) that the mistake has been rectified and that the assessee has, however, filed an appeal against the rectification order.

[Paragraph 19(iii)(b) of the Report of the Comptroller and Auditor General of India for the year 1971-72, Union Government (Civil), Revenue Receipts, Vol. II—Direct Taxes].

4.14. The Committee wanted to know the nature of cash subsidy referred to in this connection and the date on which it was paid to the assessee. They also wanted to know the date on which the excise drawback was paid to the assessee.

4.15. Department of Revenue and Insurance in a note submitted to the Committee, stated: "Under the export promotion schemes, exporters enjoy certain fiscal incentives given by the Government. Cash subsidy falls in this category. However, precise information in this regard is not available and will be reported after being ascertained with reference to the facts of the case."

4.16. As regards the dates on which the cash subsidy and excise drawback were paid to the assessee, the Ministry stated that the information was not readily available and would be reported after obtaining it from the Income-tax Officer.

4.17. When asked how the department treated these amounts as part of export sales, the Ministry, in a note, stated: "In the printed Profit & Loss Account for the year ended 31st March, 1967 the total sales were declared inclusive of cash subsidy and excise drawback. The ITO who had made the assessment explained *inter alia* that in the return of income the company had claimed deduction for export profits for the full year. As rebate was discontinued in respect of exports from 6th June, 1966, details of export sales upto 5th June, 1966 were obtained. In the Annexure to the assessment order, he had noted the export sales and deducted therefrom freight and insurance. Cash subsidy and excise drawback were shown separately. But in actual working of rebates, inadvertently export sales were taken inclusive of cash subsidy and excise drawback."

4.18. The Committee pointed out that as the Ministry must be aware, cash assistance and duty drawbacks formed part of the incentive scheme for the exports and enquired whether any instruction had been issued to the Income-tax Department to find out such amount paid to exporters with a view to see that these amounts did not escape taxation. They also wanted to know the machinery provided for collecting and utilising the information. The Ministry, in a note, stated: "For cash assistance, instructions have been issued vide Board's Instruction No. 60 (F. No. 284|69-ITA2) dated 13th June, 1969 to find out the amounts paid to exporters by the Joint/Deputy Controllers of Imports and Exports and for utilisation of the information in income-tax assessments. In the same circular machinery has also been provided for collecting the information by sending Inspectors of the Income-tax Department to the Offices of the Joint/Deputy Controllers of Imports and Exports and for passing on of the information to the concerned Income-tax Officers. For Central Excise and Customs Duty drawbacks, the matter is under examination and a further report will follow." In their instruction 60 dated the 13th June, 1969, the Board, *inter alia*, directed: "The Commissioners of Income-tax, Delhi, Bombay, Calcutta, Madras, Ernakulam and Kanpur where the offices of Joint/Deputy Chief Controllers of Imports and Exports are situated should arrange to depute an Inspector to extract information from the registers maintained in these licensing offices at their Headquarters and pass on the information to the officers in their charges and to Commission-

ers of Income-tax of the other charges covered by the jurisdiction of the licensing authority. For example, Commissioner of Income-tax, Delhi I, on getting the information extracted from the registers maintained in the office of Joint Chief Controller of Exports and Imports, New Delhi, should pass on the same to the concerned Income-tax Officers of Delhi I, Delhi II and Central Delhi and also to Commissioners of Income-tax Patiala and Rajasthan. Similar procedure should be adopted by Commissioners of Income-tax, Bombay, Calcutta, Madras, Ernakulam and Kanpur. Since the scheme for the grant of cash assistance was introduced from 6th June, 1966, arrangements may please be made to extract the information from the year 1966-67."

4.19. The Committee learnt from Audit that the Ministry had intimated that rectification under Section 154 of the Act had been done and an additional demand of Rs. 42,160 had been collected by adjustment against the refund due to the assessee for the year 1969-70. The difference in tax effect was stated to be due to the fact that the rebate on export profits had been taken by Audit to be Rs. 9837 instead of Rs. 6932 worked out by the Department. The Committee were informed by the Ministry that the assessee's appeal against the rectification order was dismissed by the Appellate Assistant Commissioner on 19th January, 1973.

4.20. Arising out of this case is the general question how the Income-tax Department can find out the quantum of cash assistance and duty drawbacks paid to the exporters with a view to ensuring that the payments received did not escape taxation. The scheme of cash assistance as an export incentive was introduced from 6th June, 1966. The grant of duty drawback was in vogue even earlier. It is surprising that it was only after three years that the Board issued instructions on 13th June, 1969 indicating how the information relating to cash assistance should be obtained for utilisation in the income-tax assessments and what is worse is no procedure has so far been laid down in regard to duty drawbacks. The Committee would like to have an explanation why this question was not taken up by the Board earlier and what action was taken against the officers concerned for the lapse. The procedure for getting information in regard to the duty drawbacks must be laid down without further delay. If this instance were typical, it is obvious that the tax collection machinery is in no way geared to function efficiently.

CHAPTER V

INCOME ESCAPING ASSESSMENT

Audit Paragraph

5.1. During its previous year relevant to the assessment year 1962-63, a non-resident company received from an Indian company payment in foreign currency equivalent of Rs. 24.37,950 as part payment for 'know-how', in accordance with an agreement in terms of which its Indian tax liability on this account was also to be borne by the Indian company. In the light of appellate orders on a similar payment for the assessment year 1964-65, the amount in foreign currency equivalent of Rs. 12,43,355 was to be treated as the post-tax-not income accruing to the non-resident company in India. The gross income would, thus, amount to Rs. 33.60,417 which should have been taxed as business income for the assessment year 1962-63. But this income was not returned by the non-resident company nor was it taxed by the department. The result was tax under-charge of Rs. 21,17,063 and short-levy of interest of Rs. 8,00,250.

5.2. During the previous year corresponding to the assessment year 1964-65, the same non-resident company received payment in foreign currency equivalent of Rs. 39.00,720 on the same account from the Indian company. The gross income accuring in India to the former as a result of this payment would amount to Rs. 56,83,905 which should have been taxed at 65 per cent, *i.e.*, tax rate leviable on business income for that assessment year. But the department treated this income as one from royalty, and charged tax at 50 per cent, which was the tax rate for royalty. This is found to be not in order, as it has been held judicially that income from the sale of 'know-how' is business income and not of the nature of royalty. The tax under-charge and short-levy of penal interest for the assessment year 1964-65 work out to Rs. 17,05,171 and Rs. 5,36,404 respectively.

5.3. For the assessment years 1962-63 and 1964-65 the under-assessment of revenue in this case thus aggregates to Rs. 51.59 lakhs (tax under-charge of Rs. 38.22 lakhs and short-levy of penal interest of Rs. 13.37 lakhs).

5.4. The Ministry have intimated (February, 1973) that they are examining the case in detail and a further report will follow in due course.

[Paragraph 20(i) of the Report of the Comptroller and Auditor General of India for the year 1971-72, Union Government (Civil), Revenue Receipts, Volume II—Direct Taxes]

5.5. This paragraph highlights a case, where, under an agreement with a foreign company to purchase know-how and patent designs, considerable income is remitted in foreign currency without subjecting the income to appropriate tax under the Income-tax Act. The company, in this case is a Canadian Company, which entered into a technical collaboration agreement with the Hindustan Steel Limited in September 1961, providing for payment of a total of 5 million Canadian dollars on account of supply of know-how to the Indian company. This amount of 5 million is for a total period of 12 years or 6 years after commencement of commercial production whichever is earlier. In terms of this agreement, a payment of 5 lakhs dollars was made in 1961 and another payment of 8 lakhs dollars was made in 1963. Both these payments were made under clause 3 of the agreement in respect of technical know-how. In the assessments for the years 1962-63 and 1964-65 it was claimed that the payments were not subject to Income-tax in India as these were received by the Canadian Company in Canada. The assessment for 1962-63 is still pending. In the assessment for 1964-65, the Income-tax Officer did not accept the assessee's claim and held that the payment, wherever made, would accrue in India where the technical know-how is actually used. The Income-tax Officer, however, treated 20 per cent of it as royalty and 20 per cent as income not taxable. The Appellate Assistant Commissioner, to whom an appeal was made, has held 60 per cent as taxable and balance 40 per cent not taxable. The AAC held it to be a business income. However, while giving effect to the AAC's orders the department treated it as a royalty and charged it to a lower tax of 50 per cent instead of 65 per cent. Further a mistake has also been committed in not grossing the income for purposes of tax.

5.6. The Committee were given to understand by Audit that after entering into an initial agreement in September 1961, a further meeting was held on 13th June, 1964 between the representatives of the two companies, minutes were drawn up and these minutes were taken to be a modification of the original agreement.

5.7. At the instance of the Committee, the Ministry have furnished a copy of the minutes of the meeting (held at Calcutta) as fur-

nished by Hindustan Steel Limited, an extract of which is given below:

> "There was discussion on the place of delivery of the know-how. The representatives of Rio Algom and Atlas Steel Co. stated that for their part after taking the advice of their own tax advisers, they had come to the conclusion that all know-how was delivered and will be delivered in Canada and in the returns filed and to be filed before the taxing authorities, they would be presenting their case in that manner. HSL representatives accepted this position and stated that in their approach to the Income-tax Authorities in India, they would confirm the statement made by Rio Algom and Atlas Steel Co. representatives. It was agreed to make this clear beyond doubt that all documents of the nature of receipts for payments would be delivered in Canada and all documents relating to know-how to be delivered to Durgapur Alloy Steels Project would also be delivered in Canada. The total price of the know-how was agreed to be 3.2 million dollars net."

5.8. The Finance Secretary added: "I would like to clarify that it was not attended by any officer of the tax department. After all, it was easy for Hindustan Steel Limited and their collaborator to discuss it and come to any agreement. The tax officer is not bound by any discussion which takes place between any people. He has got to apply his own mind. He had taken 80 per cent as Royalty."

5.9. The Ministry in a note, further stated: "...The question whether the minutes could be regarded as a modification of the original agreement will be examined on return of our file No. 224|6|70-FTD."

5.10. At the instance of the Committee, the Ministry furnished a copy of the Appellate Assistant Commissioner's order dated 25-2-1967 for the assessment year 1964-65.

5.11. With regard to the delivery of know-how, the AAC, in para 17 of his order, stated as under: "... it appears the first containing know-how was despatched by the appellant on 11-7-1962 by post to the Indian company at Durgapur. Later on 31-8-1962 three more sets were despatched by the appellant by post to India and another set was delivered in Canada to the General Manager of the Indian company when he visited Canada. The counsel intends to prove from the above is that technical know-how which was an asset was delivered

in Canada and not in India. According to him the One set of know-how delivered to the General Manager of the Indian company was the delivery of know-how in its totality. I am unable to accept the contention of the appellant. Delivery of know-how was not at all that contained in the set. It contained only some blue prints and the process for the purposes of the manufacture of the Special Steel. What was the know-how can be seen only from the agreement of 12th September 1961. It provided that the appellant shall train Indian personnel in Canada, that it shall send its technical personnel in India for exploration in India of this know-how and secret formulae and that it shall send its supervisory staff for supervision and inspection on the utilisation and working of of the said know-how in the factory established in India. That is the know-how contained all the above processes and not the one (delivery set of know-how) referred to by the Counsel. One of the know-how (training of personnel) was delivered in Canada. The second part (regarding exploitation of the know-how) was carried on in India. The third part (delivery of set) was partly done in Canada and partly in India. Thus it is clear that the delivery of know-how took place partly outside India and partly in India."

5.12. Referring to the minutes of the meeting which took place between the representative of the appellant company and the India company in 1964, the AAC in para 17 of his order stated: "From the above it is clear that the decision taken in that meeting was for action subsequent to the date of discussion. This is clear from the minutes which state: 'that there was a discussion on the place of delivery of know-how'. This is also supported from other part of the minutes when it says that 'all documents relating to know-how would also be delivered in Canada'. In reply to my query as to how it could be constructed to mean that delivery of sets should be considered to have been made in Canada which even took place a few years before the said meeting and the sets were actually sent by post to Indian concern, no satisfactory explanation was forthcoming from the Counsel. According to him minutes of the meeting was only a sort of clarification on some of the points of the agreement of 12th September 1961 which were ambiguous. This is not the correct position. In the agreement of 1961, there was no mention about this place of delivery of know-how. In the meeting of 1964, it was decided that the delivery of know-how would be made in Canada. That is, it referred to the subsequent delivery of know-how and not the know-how already delivered long before. Thus it is clear that it does not support the case of the appellant that the delivery was made in Canada. As I have held earlier, the delivery of know-how took place partly in Canada and partly in India."

5.13. The Committee enquired whether in respect of royalty payments, it was not necessary to get the agreement approved by the Government before it was entered into. The witness stated: "It has to be approved by Government.

5.14. The Committee enquired whether the agreement in this particular case was approved by the Government. The witness stated: "I presume so." The Ministry in a note stated: "The agreement between Hindustan Steel Limited and Atlas Steels Limited had been approved by the Government. The agreement does not describe the amount received by Atlas Steel Limited and brought to tax for the assessment year 1964-65 as royalty. The Income-tax Officer has, however, to determine the true nature of the receipt at the time of the assessment and the view he took was that 80 per cent of the amount received was in the nature of royalty."

5.15. The Committee enquired whether this agreement was shown to the Central Board of Revenue before it was entered into by the Hindustan Steel Ltd. in regard to ascertaining the tax liability of the foreign firm. If so, they wanted to know the advice given by the Board. The Ministry, in a note, stated: "From a copy of Board's letter F. No. 7|27|61-IT(AI) dated 24|25th November, 1961 to HSL, made available by HSL, it is seen that the question of tax liability under the agreement was referred to the Board some time in 1961. Board's file No. 7|27|61-IT(AI) is not presently available. It is, therefore, not possible to say whether it was referred to the Board by the company before the agreement was entered into. The agreement is dated 12th September, 1961 and the Board's reply dated 24|25th November, 1961 refers to the company's letter dated the 18th September, 1961."

5.16. The Committee enquired whether this was not a case falling under Section 195 of the Income-tax Act where certain remittances had been made to the non-resident company. The Joint Secretary, Department of Revenue and Insurance, stated: "Under Section 195 (i), if any payments are made to a non-resident company and they are made to a non-resident company and they are taxable under the law; certainly tax has to be deducted at source. In this case, as far as I know, tax has not been deducted at source."

5.17. The Committee pointed out under the provisions of Section 195, if the company felt that any part of its gross remittances was not taxable, it should have applied to the Income-tax Officer for exemption under Section 195(2). If the exemption was granted, there was no need to deduct any tax at all. When there was no application under Section 195(2), the company should have asked

to deduct the tax at source and remit the balance. The Committee enquired whether it was not for the officer to decide whether it was taxable or not when there was no application from this non-resident company for exemption. The witness stated: "Section 195(2) provides a machinery, wherein the assessee if he does not want to deduct tax on the whole of the income, can go to the Income-tax Officer for determining what is the portion which is taxable. If the assessee does not do it he does it on its own risk."

5.18. When asked what an Income-tax Officer would do in that particular case, the witness replied: "That will depend upon, whether any part of the payment is taxable."

5.19. In reply to a question, the witness stated: "As far as I understand, the onus is on the assessee to deduct or not to deduct. It is his choice. We cannot compel him to deduct. The I.T.O. can penalise him and charge interest and collect the money."

5.20. The Committee pointed out that the Indian company, Hindustan Steel ought to have approached the I.T.O. for grant of exemption; if they had not done that, they should have remitted the money. The I.T.O. should have taken action under Section 195 to see that Hindustan Steel Limited paid this money without first making assessment of this foreign company. To this, the witness reacted by saying: "That has not been done."

5.21. The witness further deposed: "Under the collaboration agreement, the foreign company agreed to give two major types of services, one was the supply of know-how and the other was rendering of services as production adviser. The agreement provided that the payments for supply of know-how and patents would be 3.40 million Canadian dollars; and the payments for services as production adviser were mentioned in the agreement to be 1.60 million Canadian dollars. Later on, the consolidated amount of 3.40 Canadian dollars was sub-divided into two parts viz. 0.20 million Canadian dollars for the supply of patents and 3.20 million Canadian dollars for the supply of know-how. No tax had been deducted at source on the later.

5.22. The witness continued: "Some time in 1961, when this agreement was entered into, the company made a reference to the Board asking for its decision as to what will be tax liability of the foreign company under the Income-tax Act. This agreement provides that whatever the payments, the Indian company has to make will be net of tax. That means that the tax will be payable by Hindustan

Steel Limited. That is one peculiar factor which we have to take into account. Secondly, I submitted that the company made a reference to the Board in 1961. As I said earlier there are two major services viz. supply of know-how and giving of production advice. In regard to the payment attributable to know-how, if the know-how had been delivered abroad and has been paid for abroad, it will not be liable for taxation. Payments attributable towards giving production of advice given in 1961. The Board left to the discretion of the Income-tax Officer to decide whether the know-how was delivered in India. The Income-tax Officer should have examined this question i.e. whether tax was deducted at source. If he came to the conclusion that tax was deductable, he should have ensured that it was done."

5.23. The Committee enquired, after giving the opinion, whether Board had forwarded a copy of the letter to the Commissioner of Income-tax with a view to watch that the Hindustan Steel Limited deducted taxes at source under Section 195 of Income-tax Act from the know-how, royalty and other fees paid to the foreign company and that the returns were filed on due dates in accordance with the Law. The Finance Secretary stated: "That file is not readily available."

5.24. The Ministry, in a note, added: "It has been ascertained from the Commissioner of Income-tax that the copy of the Board's F. No. 7|27|61-IT(AI) dated 24|25th November, 1961 to the Liaison Officer, Hindustan Steel Limited was not received in his office; Board's file cited above is not available now."

5.25. The Committee wanted to know the view of Board whether the payment attributable to technical know-how viz. 3.20 millions Canadian dollars was not taxable or a part of it was taxable. The Joint Secretary, Department of Revenue and Insurance stated: "This point has been under the examination of the Board on a point referred by the Ministry. We have examined this matter in consultation with the Law Ministry."

5.26. To a question the witness stated that the Law Ministry was consulted twice and that there were some earlier reference to that Ministry.

5.27. The witness continued: "Recently the matter was discussed with the Law Ministry twice, i.e. once when we were examining the case and we came to the conclusion that this payment attribut-

able to technical know-how viz. 3.20 million Canadian dollars is not taxable. The Law Ministry agreed with us. Before we could inform the Hindustan Steel, the audit objection came to our notice. Therefore we withheld it. Thereafter a detailed note was recorded in the light of the Audit objection. We referred the matter again to the Law Ministry; but while agreeing with our view *prima facie*, they suggested that we should have a discussion where the Audit's representative may also be present. The matter is pending at this stage. We have not been able to hold a tripartite discussion with the Law Ministry, ourselves and the Audit's representative." The Finance Secretary added: "The main point here is that if a tax is leviable, it will ultimately have to be recovered from the Hindustan Steel Limited because that is the agreement. It only means that as Secretary in charge of the Department of Revenue, I tax the Hindustan Steel Limited; I levy a tax on this company, collect it from the Hindustan Steel and then, as Finance Secretary, I give the Hindustan Steel a subsidy for covering the tax payments. It has been secured by this party, by saying that whatever money is given to them, should be net of tax. Hindustan Steel will pay the tax on their payments so that they i.e. the party have no responsibility of taxes. They say 'what you should pay us are these net amounts'; and so far as the alloy steel is concerned, we are beggars and not choosers. We have got it after a great difficulty."

5.28. Elaborating further, the Finance Secretary deposed: "No country, ... has given us technical know-how without taking a stiff payment. Now, they are saying, 'you give us net of tax'. They do not want to get into these difficulties of tax. Whatever tax we raise, will have to be borne by us. And we are in consultation with the Law Ministry on the question of whether a tax is payable or not. A view has been held that if a know-how is given abroad, no tax is leviable-i.e. if they have not made any payments in the country. But this is under consultation with the Law Ministry. If the question of payment of tax arises, then we shall have to gross it up and collect it from the Hindustan Steel Limited. Since HSL is running into losses, I will have to pay them something to cover this."

5.29. When asked about the foreign exchange part of it, the Finance Secretary replied that there was no point of foreign exchange involved.

5.30. In a written note, the Ministry further stated: "In regard to the number of references made to the Ministry of Law in the

case of Atlas Steels Limited regarding taxability of foreign company under the agreement, the position is under:

Date of reference	Date of reply from Law Ministry
(1) 5-10-1971 .	13-10-1971
(2) 10-11-1971 . .	17-11-1971 (referred back)
30-11-1971 (Returned)	23-12-1971
(3) 31-7-1972	31-10-1972
(4) 4-9-1973 . . .	16-9-1973 (Interim reply)

It is seen that finally on 4-9-1973 the Ministry argued that the relevant payment was a payment for technical know-how, that the technical know-how represented by six sets of Atlas Processing Standards had been delivered from abroad and that no part of the payment could be apportioned as relating to the operations carried out in India. The Ministry of Law agreed to this view on 26-9-1973.

5.31. According to the Audit, the following points were made in the Audit Report in connection with the assessment:

(i) Income from the sale of know-how is business income chargeable to tax at the rate of 65 per cent and not income by way of royalty charegable at lower rate of 50 per cent.

(ii) Income is liable to Indian Income-tax on the basis of accrual.

5.32. Audit has further stated: "As regards point (i), the position has been examined at length in paragraphs 29 to 39 of the note dated 1-9-1973 in the Ministry's File No. 224|6|70-FTD. It has been concluded that 'the audit has rightly observed that income derived from the sale of know-how is business income. Authority for this view is available in the House of Lord's decision in the cases of Jeffery Vs. Rolls Royce (40 Tax Cases 443) and Musker Vs. English Electric Company Ltd. (41 Tax Cases 556) and the decision of the Bombay High Court in the case of Commissioner of Income-tax Vs. Cilag Ltd. (70 ITR 760)." Nevertheless, a somewhat inverted logic has been used sub-sequently to come to the conclusion than an income chargeable under the head 'Profits and gains of business' does not cease to be an income in the nature of royalty and hence in the present case even it is a business income it is still income in the nature of royalty and therefore chargeable at the lower rate of tax applicable to royalty. The relevant finance Act makes a distinction between the income

from royalty and the other income and prescribed different rates of tax for the two. The rate of tax for income from royalty as laid down in the Finance Act is not applicable to any income but the income from royalties.

With regard to point (ii) about the liability to Income-tax in India, the position was examined in the Ministry of Finance between October 1971 and September 1973 and the case was referred to the Ministry of Law (from time to time) for opinion. The decision taken in this respect is neither in accordance with the provisions of the Law nor in accordance with the facts of the case. The payment received by the Canadian company has to be viewed in the context of the agreement as a whole, the transfer of technical know-how is not limited to the delivery of six sets of processing standards, there is admittedly a business connection in terms of Section 9 of the Act and the income has to be considered as income deemed to accrue or arise in India. It is inconceivable that 'know-how' can be delivered at a 'place'—like a moveable property. As pointed out in R. M. Kayee case, it is not confined to 'books and phamplets'. The point has been examined also in a recent decision of the Madras High Court in commissioner of Income Tax Madras Vs. Carborundum Company (92 ITR 411). .... It seems that by issuing the 1969 circular, the hands of the I.T.O.'s were tied and a good amount of foreign exchange has been paid out without even deducting tax at source. The relevant income is liable to income-tax in India under Section 9 of the Income-tax Act 1961 and is taxable at the higher rate of 65 per cent."

5.33. An extract of the judgement delivered on the 4th May, 1973 by the Madras High Court in the case of Commissioner of Income-tax Madras Vs. Carborundum Company (92 ITR 411) referred to by Audit is reproduced below:

> "In Jeffrey Vs. Rolls Royce Ltd. it is observed that exploitation of 'know-how' is one method of development of the owner's own trade, though it may not amount to a separate business. The assessee, therefore, is not right in its submission that in cases of 'know-how' agreement there is no question of any business connection. As already stated in this case the agreement is not only a 'know-how' agreement but also an agreement to provide foreign technicians to work in India to assist the Indian company and also to train the Indian personnel in the manufacture of the products. Therefore we are of the view that the assessee having rendered at least some services in India which amounts to a business activity, the technical fee should be taken to have accrued or from its business connection in

India. In that view the entire receipts by the assessee company has to be taken to have accrued or arisen in India as a result of its business connection and therefore, taxable. The apportionment made by the Commissioner or the one made by the Income-tax Officer cannot, therefore, be sustained for the assessee cannot be said to have carried on business in India in the context of definition of 'business' and therefore, there is no question of any apportionment."

5.34. The Committee wanted to know the definition of 'Royalty' and 'know-how'. The Joint Secretary, Department of Revenue and Insurance, stated: "By royalty we generally mean the payments which are required to be made for the use of patents and trade marks. The word 'know-how' has not been defined as such in our Income-tax Law or rules. It has received interpretation from various High Courts and also the foreign Courts particularly in U.K. and it has generally come to acquire a meaning that it refers to unpatented technical information which a producer of goods has developed in the course of its manufacture for the manufacturing of these aritcles. It will be absolute knowledge of that person who has produced those goods."

5.35. The Committee drew attention of the witness to paragraphs 3.1 and 3.6 of the agreement wherein it was stated: "Secret knowledge and know-how will also include the extensive metallurgical and operational knowledge and experience of Atlas with respect to manufacturing procedures and works methods for the segregation and selection of steel scrap and other raw materials, steel melting procedures by the latest electric are...

Atlast is to supply to Hindustan Steel Limited, free of additional cost, an adequate number of (not exceeding six) copies of all written formulae, standards, processes and technical and other data referred to in paragraphs 3, 3.1 and 7 of the agreement."

5.36. Pointing out that according to the paragraph 3.6 of the agreement, the six copies containing secret formulae. etc. and received by the Hindustan Steel Ltd. from Atlas Steel Limited, were free of additional cost and in addition to the secret knowledge and know-how, the Committee wanted to know the main item received by HSL as know-how for which a sum of Rs. 3.2 million Canadian dollars had to be paid. The Finance Secretary stated: "The main item is the secret formulae for manufacturing the alloy steel. That can be given in a book form. We have paid for the know-how; and without the books we cannot produce the alloy steel. The know-how is not available with anybody except this company."

5.37. The Joint Secretary, Department of Revenue and Insurance added: "As far as we have understood this agreement it is that the Atlas were to give the technical know-how for the manufacture of alloy steel and this know-how was contained in the form of drawings, secret-formulae and designs, etc. in a set of books of 18 volumes of which six copies were supplied."

5.38. The Committee learnt from Audit that an order was passed in January 1966 recognising the foreign company as a company under the Income-tax Act in modification of a prior order of 1965. The Committee desired to know the nature of the prior order and the circumstances under which it was modified. The Department of Revenue and Insurance, in a note, stated: "On 2-1-65, the Central Board of Direct Taxes passed an order declaring Atlas Steels Ltd., Canada to be a company for the purposes of the Income-tax, the declaration having effect from the assessment year 1964-65. On 25-1-1966 this order was partially modified directing that the declaration granted to Atlas Steels Ltd. shall have effect from the assessment year 1960-61. File No. 60|96|64-IT(B) in which both the orders were passed has been destroyed. From the nature of the order subsequently passed, it appears that the company approached the Board with a request for retrospective declaration as a company from the assessment year 1960-61."

5.39. The Committee enquired whether the latter order was communicated to the Commissioner of Income-tax. The Ministry in a note stated:

> "From a copy of the order of January, 1966 applied by the Chartered Accountants, available in the records it is seen that the copy of the said order was endorsed to the Commissioner of Income-tax, Patna."

5.40. The Committee desired to know the date on which the first return was filed by the Atlas Steel Limited, the income returned, and the income on which the assessee was assessed to income-tax. They also wanted to know the view taken by the Income-tax Officer in relation to the agreement. The Joint Secretary stated: "We are checking up from the records, but the only assessment which, as far as I remember, appears to have been made so far is the assessment for 1964-65. The Ministry, in a note, stated: "It appears from the information furnished the authorised representatives of M/s Atlas Steels Limited that the first income-tax return filed by Atlas Steels Ltd. was for the assessment year 1965-66 and it was sent to the Income-tax Officer, Patna on 22-6-65 by registered post. On a perusal of the assessment records in West Bengal it does not appear that the said return

was forwarded to the West Bengal charge by the Income-tax Officer, Patna. However, the assessee company filed a copy of the said return before the Income-tax Officer, Calcutta on 23-12-65 and it disclosed a loss of Rs. 78,995/-. The company filed three more revised returns, the last one being on 5-12-69 disclosing a loss of Rs. 55,863/-. This assessment was completed on 30-3-70 on a total income of Rs. 1,16,647/-. An appeal against the said assessment is now before the A.A.C.

Although the return for the assessment year 1965-66 was the first income-tax return filed by the assessee it was the assessment for the assessment year 1964-65 that was first completed in this case. After filing a return for this year on 24-3-66, the assessee filed two revised returns, the last one on 10-7-68 disclosing a loss of Rs. 3,774/-. The assessment was completed on 28-3-69 on a total income of Rs. 55,18,185 and was reduced in appeal by the A.A.C. to Rs. 35,85,877. The matter is now pending before the Tribunal."

5.41. The Committee learnt from Audit that the Ministry in a note had stated that so far as 1962-63 and 1963-64 were concerned, no returns were filed by the assessee, though an agreement between the Hindustan Steel Ltd. and the assessee was filed before the Income-tax Officer in December, 1967 (agreement entered into in 1961). But the Income-tax Officer initiated action under Section 147(2) on 4-2-1971. Notice was served on 22-3-1971 and no return had been filed by the assessee.

5.42. The Committee desired to know the circumstances which led the Income-tax Officer to initiate action under Section 147(a) for the assessment year 1964-65 in February, 1971. The Ministry, in a note, stated: "(i) The assessment for the assessment year 1964-65 was completed by the I.T.O. on 28-3-1969. There is no indication that this assessment has been reopened under section 147. Approval was granted to the I.T.O. in February, 1971 to initiate action under section 147(a) for the assessment year 1962-63; and (ii) The assessment proceedings for assessment year 1962-63 are still pending."

5.43. To a question, the witness stated: "The assessment was made for 1964-65. The matter is pending before the Tribunal. I think he (Income-tax Officer) is awaiting the instructions of the Board in regard to the other year."

It is, however, seen from the information subsequently furnished

by the Ministry that assessment have been made for the assessment years 1964-65 to 1969-70.

5.44. The Committee enquired whether the Board has issued clarifications for the guidance of the Income-tax Officers relating to assessment of royalties and know-how received by foreign concerns from Indian concerns. The witness stated: "The latest instructions are contained in its letter dated 17-4-1969." The Ministry, in a note, added: "At the 12th meeting of the Central Direct Taxes Advisory Committee there was a suggestion that there was great deal of uncertainty regarding tax consequences of foreign collaboration agreements and that Government should issue clear cut and detailed instructions to the assessing authorities on the subject. The Committee was given an assurance that the tax problem involved would be reviewed by the Board and guideline laid down for the assessing officers to secure uniformity and certainty of tax treatment in such cases. In pursuance of the assurance, detailed instructions were issued to the officers of the Department by Board by F. No. 7A/19|68-IT (AII) [Instruction No. 37] dated 17-4-1969. Later a Public Circular No. 21 of 1969 was issued on 9th July, 1969."

5.45. The Committee desired to know the legal position in relation to assessment of amounts received for use in know-how. The Ministry, in a note, stated: "If the consideration for know-how is received by the foreign collaborator or on his behalf in India then the amount would be taxable in India on receipt basis. If the supply of know-how takes place outside India and the payment also is made outside India, the amount will not be liable to tax in India. However, if the agreement is entered into in India, a small part of the amount will be liable to tax in India in view of the Supreme Court's decision in the case of Union Tile Exporters [71 ITR p. 453].

As regards the assessment of amounts received for the user of know-how, the legal position appears to be that consideration paid purely for the user of know-how over which the foreign collaborator retains ownership and control will be liable to be taxed in India; the final position is however under consideration in consultation with the Ministry of Law."

5.46. When asked about the practice of the department in assessment of know-how in other cases, the Ministry, in a note, stated: "The general practice is that consideration received by a foreign collaborator outside India for the supply of know-how outside India

is not taxed in India. If the agreement is made in India an appropriately small portion of the profits attributable to the making of the agreement is held as having accrued in India and subject to tax in India. Where the consideration is received by the foreign collaborator in India or where the foreign collaborator supplies the know-how in India, income in this regard is held to be taxable in India. Where the shares of an Indian company are allotted to a foreign collaborator in consideration for supply of technical know-how from abroad, it has been decided not to tax profits on such transactions merely on the ground that sites of the shares are in India."

5.47. The Committee wanted to know whether the Board had issued any instructions or guidelines for the purpose of appointment. The Ministry, in a note, stated: "The Board has instructed in its letter F. No. 7A|19|68 IT(AII) dated 17-4-1969 (Instruction No. 37 of the 1969) that allocation of the payment among the various services in India and abroad and towards royalty element included in the payment has to be made objectively and after a careful appraisal of the precise terms of the collaboration agreement and the actual manner in which the terms have been implemented in practice."

5.48. The Committee wanted to know the circumstances that led the Income-tax Officer to treat 80 per cent of the income as royalty when it was never claimed by the assessee that it was a royalty payment. The witness stated: "We will check up on this."

5.49. The Ministry, in a note, stated: "The company's claim was that no part of the amount was taxable. The Income-tax Officer has observed in his order that payments received by the company either in India or abroad as royalty for use of secret (know-how) formulae, secret designs etc., accrue at the point where they are used, and 80 per cent of the receipts can be attributed to royalty for use of secret formulae and designs."

5.50. In question 2(e) of their Advance Questionnaire sent to the Ministry on 17th July, 1973, the Committee desired to know the number of Indian companies which had collaboration agreements with foreign companies and the total amount of royalty, know-how fees and other charges paid to the foreign companies in terms of such collaboration agreements.

5.51. The information as furnished by the Ministry is as under:

(1) Number of Indian companies having collaboration agreements with 351 foreign companies.

(2) *Total amount of royalty, know-how fees, technical fees and other charges paid and payable:*

	Actually paid	*Payable*	*Total*
Royalty	7,18,73,534	12,04,17,781	19,22,91,315
Fees for Technical Services	3,73 39,720	4,97,52,215	8,70,91,935
Know-how fees	1,54,72,271	1,69,74,109	3,24,46,380
Other charges	1,22,04,213	1,38,05,373	2,60,09,586
	13,68,89,738	20,09,49,478	33,78,39,216

5.52. Pointing out that the know-how fees paid to the foreign companies worked out only about 1/6th of the royalty fees, the Committee enquired whether it was a fact that considerably less portion of know-how was utilised than the patent rights for which royalties were paid. The witness stated: "Under this item 2(e) of the Advance Questionnaire, we have submitted the information that royalties payable by the Indian companies for the assessment year 1971-72 amounted to Rs. 12.04 crores. As against that know-how fees amounted to Rs. 1.70 crores, which is roughly about 1/6th. This depends on the terms of agreement. We generally go by the terms of the agreement. These agreements are approved by the Government. The I.T.O. is not debarred from going behind the agreement."

5.53. The Finance Secretary, added: "I would like to submit that no foreign collaborator is willing to enter into an agreement for payments which include tax. They always want net so that they do not have any difficulty later. They do not want to get themselves involved with the tax department..... If we have stiff conditions, we will not get the know-how. If we get, the Indian party will have to pay the tax."

5.54. The Committee wanted to know the practice followed in other countries in this regard. The witness stated: "We shall find out. But here we are not the choosers; we are the beggars." The Ministry, in a note, stated: "The position is being ascertained from the Department of Economic Affairs and the Ministry of External Affairs after which a further reply will follow."

5.55. The Committee asked why there was a different rate of tax on royalty and whether royalty could not be treated as business in-

come in all cases, the witness deposed: "There is a different rate of tax on royalty. It was 50 per cent on royalty payable under approved agreements as against 65 per cent on general incomes. This was a concession given in the Finance Act. Otherwise, perhaps, they will ask for greater royalty. That is why we reduced the rate of tax."

5.56. The Finance Secretary added: "After all, we have to give certain inducements to get technical knowledge which is avoidable to us under very stringent conditions. Government has taken this decision to give certain concessions on royalty for getting the technical knowledge."

5.57. In reply to a question, the witness stated: "As far as this technical know-how is concerned, we have progressed in that direction and that would not have been possible unless we were to get this technical collaboration. After all the general industrial growth has something to do with the technical collaboration."

5.58. The Committee enquired whether it was reflected in the field of Gross National Product. The witness stated: "It may not be reflected in Gross National Product, but we can give you information as to how far this technical collaboration has helped us to manufacture commodities which would not have been manufactured in this country and which have saved us a lot of foreign exchange."

5.59. The Committee wanted to know the advantage derived in this regard in the priority sector. The Ministry, in a note, stated: "The Economic Adviser, Ministry of Industrial Development has been requested to give the necessary information and a further reply will be sent after this is received."

5.60. The Committee desired to know whether the Ministry had issued instructions advising all the other Administrative Ministries to refer all the collaboration agreements to them and not to give assurances regarding tax liabilities without consulting the Ministry of Finance (Revenue Department). If so, they wanted to know the number of such agreements that had been referred to that Ministry. The Ministry, in a note, stated: "A copy of the Ministry of Finance O.M. No. 20|274|58-IT dated 11-11-1959 addressed to other Ministries requesting them not to give any assurances in the matter of tax liability without its prior concurrence has already been forwarded."

5.61. The Committee wanted to know the system by which all agreements entered into by foreign companies with Indian companies for the purpose of payment of know-how or for other services rendered, were scrutinised properly with a view to ascertaining the tax liability. The witness stated: "The agreement is approved by the Administrative Ministry concerned with the help of Foreign Investment Board. One copy of the letter of approval at that stage is forwarded to the Commissioner and one copy is kept by us. At that stage, the tax provisions of the agreement are not gone into by the Board. Recently, we have circulated a list of three thousand and odd collaboration cases between the foreign parties and the Indian parties, to our Commissioners so that they could verify whether action has been taken in all these cases."

5.62. When asked whether, before the agreement was finalised, the Department at any point of time made any efforts to ensure that the tax interest of the country was safeguarded, the witness replied: "I am given to understand that we have not taken any initiative in this respect that the Board should be consulted at the stage when a collaboration agreement is approved at the initial stage."

5.63. The Audit paragraph brings out a case where under an agreement with a foreign company to purchase 'know-how' considerable income is remitted in foreign currency without subjecting the income to appropriate tax under the Income-tax Act. Under the agreement the foreign company's Indian tax liability was to be borne by the Indian company. The agreement provided for payment of a total of 3.2 million Canadian dollars for the supply of know-how. Although several payments were made, no tax had been deducted at source. A payment of 5 lakh dollars was made in 1961 and another payment of 8 lakhs dollars was made in 1963. In the assessment years 1962-63 and 1964-65, it was claimed that the payments were not subject to income-tax in India as these were received by the foreign company abroad. The assessment for 1962-63 is still pending, which would involve undercharge of tax/interest to the extent of Rs. 29.17 lakhs if the claim is accepted. For the assessment year 1964-65, only 60 per cent of the income was treated as taxable and it was charged to tax at the rate of 50 per cent as royalty instead of as business income at the rate of 65 per cent. Further, the income was not grossed up for purposes of tax. All these involved short-levy of tax/interest to the extent of Rs. 22.42 lakhs which is a substantial amount.

5.64. It was held that the delivery of know-how took place partly outside India and partly in India and accordingly the income was apportioned for the purpose of taxation. The Committee find that

there was no provision in the agreement executed in 1961 about the place of delivery of know-how. There was, however, some discussion between the representatives of the Indian and foreign companies on 13th June, 1964 regarding the place of delivery. The Committe do not consider that the minutes of the meeting could be regarded as modification of the original agreement.

5.65. The agreement did not describe the amount received by the foreign company as royalty. As the payment is for 'know-how' which is the subject-matter of business agreement between the companies, it can only be regarded as business income and not royalty.

5.66. Strangely enough, after protracted consultations between the Ministry of Finance and the Ministry of Law it has been finally held that the payment is for technical know-how, that the technical know-how represented by 6 sets of processing standards only had been delivered from abroad and that no part of the payment could be apportioned as relating to the operations carried out in India. It is inconceivable that the transfer of know-how is limited to the delivery of merely 6 sets of processing standards for which the country had to pay through its nose. The payment received by the foreign company has to be viewed in the context of the agreement as a whole. There is admittedly a busines connection in terms of Section 9 of the Act and the income has, therefore, to be essentially considered as income deemed to accrue or arise in India. The Committee find that the point has also been examined in a recent decision of the Madras High Court in Commissioner of Income-tax Madras Vs. Carborundum Company (92 ITR 411). The Committee were told that it is proposed to examine the matter again in consultation with the Ministry of Law associating the Audit representaive. The Committee would urge that this should be done immediately. The Committee further desire that it should also be examined as to what should be the income that should be brought to tax when an agreement stipulates that a certain amount is to be paid net of tax, if that is really permissible.

5.67. The Committee would like to know the action taken to revise the relevant assessments of the company and collect the appropriate revenue in the light of the above. They suggest that the Board's instructions of 17-4-1969 should also be suitably modified.

5.68. The total amount of royalty payment assessed to tax upto the assessment year 1971-72 in respect of Indian companies having collaboration agreements with foreign companies was Rs. 19.23 **crores whereas the total amount of know-how fees was only Rs. 3.24 crores. As know-how fees attract a higher rate of tax (65 per cent) it is necessary to lay down clear guidelines as to how the payments should be identified as relating to royalties or know-how. In this connection the Committee find that the word 'know-how' has not been defined as such in the Income-tax laws or rules. The Committee, therefore, stress that the opinion of the Attorney General should be obtained and suitable instructions issued to the assessing officers forthwith for guidance.**

5.69. The Committee regret to find that at present it is not being ensured that the Central Board of Direct Taxes are consulted at the stage when collaboration agreements involving tax matters are approved. The Government should explain and examine how such a serious lacuna has been allowed to continue for so long. The Committee are not at all satisfied with the extent of scrutiny conducted by the Ministry of Finance in regard to the agreements entered into under the advice and with the approval of the various administrative Ministries particularly by the public sector undertakings. They accordingly emphasise that the Ministry should work out a fool-proof arrangement so that our limited resources are not frittered away in the way, it appears, has happened in the above mentioned cases.

5.70. A reference inviting attention to an earlier telephone conversation with the Chairman, Central Board of Direct Taxes from the Chairman of an Indian Company, where Government has substantial financial interests, located in Calcutta, dated 7-7-1972 was received in the Board's Office on the same day. (A draft dated 1-7-1972 purporting to be a technical collaboration agreement with a private foreign company for setting up a paper making machinery said to have been enclosed to his reference was not received therewith). This letter was marked 'Please treat this as most urgent' by the Chairman, Central Board of Direct Taxes, on the very same day.

5.71. Under the terms of the proposed agreement the following three types of payments were payable to the said foreign private company:

(a) For initial two years of agreement a total lumpsum technical assistance fee of U.S. $ 60,000 payable in three instalments.

(b) For the subsequent 8 years of the agreement a technical assistance fee of 2½ per cent of the net sale price of the equipment.

(c) Royalty @ 2 1|2 per cent calculated on the net sale price of equipment.

Stating that it is the understanding of the Indian Company that the technical assistance fee mentioned in items 1 & 2 would not be subject to Indian tax, the Chairman of the Company requested the Chairman, Central Board of Direct Taxes to give his 'official opinion' in this matter. On 14-7-1972 a report of the Commissioner was called for urgently. The Commissioner replied since he was not in receipt of the copy of the agreement, it would not be possible for him to send the reply. In the meantime on 15-7-1972, the Additional Secretary, Ministry of Industrial Development wrote to the Chairman, Central Board of Direct Taxes requesting the Board to furnish the advice early. On 19-8-1972, a copy of the draft agreement was sent to the Commissioner. After this, it would appear that the representatives of a Company who are the foreign company's tax advisers in India had preliminary discussion with the Income-tax Officer who have an indication that with a technical fee covered by item (b) above would be taxable. Immediately, thereafter, the Managing Director of the Indian Company wrote to the Chairman, Central Board of Direct Taxes stating that a final decision should be given urgently and on receipt of this letter the case was asked to be examined independently of the report of the Commissioner. The Commissioner on 25-9-1972 replies that the actual tax liability would depend upon the manner and mode of execution of the contract and the Board should not express an opinion. Nevertheless the Board examined the issue and asked the opinion of the Law Ministry. The Ministry of Law was consulted on three occasions on the same issue. After the three consultations were held a letter was issued on 16-5-1973 to the Chairman of the company in which the advice was given that if the Indian company desired that the technical assistance fee should also be exempt from tax they may consider the desirability of converting the payment of periodical fee linked with production in India into a lumsum fee with a safeguard as to minimum production. An indication is also given in para 4 that if the agreement is executed abroad no part would be taxable in India.

5.72. An extract of the letter dated the 16th May, 1973 from the Ministry of Finance to the Chairman of the company is reproduced below:

"2. On the basis of the facts stated, it is confirmed that the

amount of $ 6,00,000 payable outside India in three instalments in the initial two years for the transfer of know-how will not be liable to tax under the Income-tax Act, 1961. However, as regards the second payment, viz. 'technical assistance fee' of 2½% of the net sale price of all licensed paper machinery, etc., referred to in section VIII (a) (II) of the draft collaboration agreement, it is difficult to appreciate the distinction between this payment and the payment of 'royalty' for rights granted to.. (Indian company) to manufacture or sell the licensed paper machinery at the rate of 2½% of the net ex-factory selling price etc., referred to in section VIII (b) of the said Agreement. Further, both these payments become due to....immediately after final despatch of the machinery from the manufacturer's works.

3. If.... (Indian company) desire that the technical assistance fee for the transfer of know-how should also be exempt from tax, you may consider the desirability of converting the payment of this periodical fee linked with production in India into a lumpsum fee with, if necessary, safeguards as to the minimum production. If, however, this is not possible and it is proposed to pursue the claim for exemption from tax on the basis of the existing draft Agreement, you are requested to let us know the basis upon which a distinction is sought to be made between the two categories of payments referred to above so that the matter could be considered further...

4. We do not know whether the agreement will be executed in India or abroad but I may add that in accordance with the decision of the Supreme Court in the case of C.I.T. *vs.* Union Tile Exporters (71 ITR 453), an appropriately small part of the net profit arising to....on the while contract will be taxable as income accuring or arising in India if the contract is made in India."

5.73. It is understood that the latest judgement in the Commissioner of Income-tax *vs.* Carborundum Company, reported in 92 ITR 411, clearly goes against the opinion given by the Law Ministry and the view taken by the Finance Ministry.

5.74. The Committee wanted to know the authority under which the officials of the Board or the officials of the Finance Ministry were allowed to give advice in such cases. The representative of the Ministry of Finance stated "In regard to foreign collaboration cases, we issued a circular in 1969 and it has been mentioned there

that the assessees can make a reference to the Board for a ruling as to the tax liability under these foreign collaboration cases and in pursuance of that decision of the Board, we are entertaining such petitions."

5.75. When asked whether an advice could be given on specific issues, the witness stated: "The specific issue, in this case, is what is the tax liability of a foreign party in view of such and such a foreign collaboration agreement which is being approved by the Government."

5.76. The Committee drew attention of the witness to paragraph 3 of the letter dated the 16th May, 1973 written by the Ministry of Finance to the Chairman of the Indian company and pointed out that legally the Income-tax Officer was the only competent authority to give advance rulings in such cases and the Board|Department was pre-empting him by giving such advices. This could be construed to imply that the Board may going out of the way to advise the party as to how to avoid tax to this the witness reacted by stating "On this my submission is this. Under Section 195 of the Income-tax Act, any person can come to an Income-tax Officer and seek an advance ruling as to what is the extent of percentage of payment that would be taxable. Legally, the Income-tax Officer has been given the power of giving an advance ruling. The Board has taken a decision in 1969 that the Board will also give advance ruling. In the circular instructions which were also issued as a public instruction, the Board agreed to give advance ruling in such cases. This is what we have said in the circular."

5.77. The witness added: "This agreement involving....provides for two sets of payments for transfer of know-how. The first is a lumpsum of $ 6,00,000 payable in three instalments during the initial 2 years of the agreement; and the second is a technical assistance fee, as they permit, of 2½% of the net sales of all licensed paper machinery manufactured by.....The third payment was for a right to manufacture and sell licensed paper machinery *i.e.* a royalty at the rate of 2½% on the net selling price of the paper manufacturing machinery. We gave the advice *viz.* that in accordance with our normal legal interpretation that if the payment for providing know-how is made abroad and the technical know-how is also delivered abroad, this lumpsum of $ 6 lakhs may not be taxable.

5.78. Coming to the second point, this was perhaps one of the first cases of the type that we had to examine *i.e.* where the payment for the transfer of know-how was also expressed as a percentage of production in India. Therefore, we took the view in the Department that we should start by saying that it is taxable. The company took

the view that it is not taxable, because it is a payment for the transfer of know-how. At that stage we consulted the Law Ministry. It is on the basis of para 6 of the Ministry of Law's advice that I had included this para in my letter...."

5.79. He further stated: "As I submitted, it may be a wrong decision on my part, but I would submit that we included this pararaph on the advice of the Law Ministry. I will read out the relevant portion from the Law Ministry's advice:

> "The company might be addressed asking them for the basis upon which they have distinguished between the two categories of payments and also suggesting that they may consider the desirability of converting the payment falling in the second category also into a lumpsum fee with, if necessary, safeguards as to the minimum production, if they wish to be completely certain about its non-taxability."

5.80. To a question the witness replied: "I did it in view of the advice given to me by my legal adviser..... The reply had been issued after the file had been shown to the Chairman (CBDT)."

5.81. The Finance Secretary added: "I would like to say that certain enquiries are received not only from the foreign collaborators but also the Indian collaborators who are seeking foreign collaboration regarding the tax laws in certain respects. I do not see anything objectionable in giving classification in general terms, not a specific advice relating to a particular case. I agree with you that the advice which is given by the Board should not be in a specific instance. It should be in general terms. I do not agree with para 3. I will look into this."

5.82. When asked about the number of occasions in which the Law Ministry was consulted in this matter, the Joint Secretary state: "We had consulted the Law Ministry on this point on one occasion earlier. I went there personally for a discussion with the Joint Secretary (Law). On the point of 2½ per cent on technical know-how, I was wanting to take the view that it should be taxed. In this particular file, a tentative view had already been taken that this 2½ per cent will not be taxed. I took the view that it should be taxed".

5.83. The Ministry, in the forwarding letter, *inter-alia*, stated: "The matter has since been looked into.... The point referred to in the finance Secretary's note dated 26-12-1973 is being separately examined."

5.84. The Ministry also forwarded the relevant files in this regard for the persual of the Committee.

5.85. The Finance Secretary, in his note dated the 26th Decem-

ber, 1973, has observed: "I had already expressed my views before the P.A.C. If we accept the basic premises that the tax determination in a particular case has to be made by the I.T.O. in a quasi-judicial proceeding, then it would be that the Board can only express a view in general terms. Is there no provision in the Law which enables a company to obtain advice from the concerned I regarding the tax liability? This may be examined further."

5.86. It is learnt from the Ministry's file that the formal agreement had already been executed by the undertaking with foreign company on 22nd November, 1972 and the agreement is identical to the draft agreement sent to the C.B.D.T. earlier. The undertaking has asked the Board to consider the matter regarding the taxability of the amount in question and that the matter is pending.

5.87 A ruling given by the Ministry in May, 1973 in regard to the tax liability of a foreign company under a collaboration agreement with an Indian company in which the Government of India have 51 per cent of shares and L.I.C. 23 per cent of shares came to the notice of the Committee. The facts narrated by the Committee in the foregoing paragraphs would indicate how the Ministry went out of the way on the suggestion of the Ministry of Law and sought modification in the terms of the agreement if certain payments to be made to the foreign company for so called know-how were to be exempted from tax. The Finance Secretary clearly agreed with the view that advice should not be in a specific instance. According to him if the basic premise is accepted that the tax determination in a particular case has to be made by the ITO in a quasi-judicial proceeding, then only would the Board express a view in general terms. The matter therefore requires thorough inquiry in depth so as to set out clearly the scope of advice which may be given by the Ministry of Finance (Foreign Tax Division) in such matters.

5.88. Incidentally, the Committee find that the collaboration agreement had already been finalised in November, 1972 incorporating the relevant terms as originally proposed by the undertakings. The determination of tax liability is stated to be pending. The Committee would like to know the final decision, if any, taken in the matter keeping in view the above observations as well as in the earlier case concerning collaboration agreement of Hindustan Steel with a foreign company.

5.89. The question of the Board's giving advance ruling had been raised before the various committees and commissions which inquired into direct tax administration. In this connection the Committee would refer to paragraph 6.179 of Direct Taxes Enquiry Committee's

final report (December, 1971). It appears that unless the Board is authorised by law to give advance rulings the Board should not give advance ruling. The Committee, therefore, desire that in order to place the matter on a legal footing necessary amendment to the law should be considered early.

5.90. At present the advance ruling in regard to foreign colaboration agreement seems to be given by the Foreign Tax Division of the Ministry of Finance. As this Division is not a part of the Board, it would appear that it may not be competent to give advance rulings even if the Board is authorised by law This aspect also requires examination.

5.91. The advice (not ruling) should be not for avoidance/or for finding loopholes but it should be in the nature of a general analysis of law as it stands and no more.The Board should not have powers to render regular consultancy service.

Audit Paragraph

5.92. An assessee company engaged in Chit Fund business was subscribing to vacant chits according to the rules of the Fund. The dividend earned by the company on the vacant chits so subscribed to by the company was not reated as income earned by the company but was being exhibited in the balance sheet. The department also did not include the same under total income for levy of income-tax on the ground that the income earned was only notional. According to the rules of the Fund, when the vacant chits are subscribed or allotted to a new member, the new allottee is not entitled to past dividends. Furher, the dividends accrued resulting from the discount paid by the successful bidder at the auctions are payable to each and every chit including those held by the Fund. Thus, the dividend earned by the Fund in respect of chits subscribed to by it is not notional but real income. The short assessment noticed for assessment years 1967-68 to 1970-71 was Rs. 55,078 with a consequential short demand of tax of Rs. 35,801. The Ministry have reported (February, 1973) that as a precautionary steps, the department is being asked to take remedial measures.

[Paragraph 20(ii) of the Report of the Comptroller and Auditor General of India for the year 1971-72, Union Government (Civil), Revenue Receipts, Vol. II—Direct Taxes].

5.93. In Audit's view, the dividends accrued in respect of vacant chits are to be treated as income-tax assessments of Chit Funds. It is understood from Audit that Audit has taken up the matter with the Ministry through a detailed letter dated 12-10-1973 to which a reply is awaited.

5.94. The Committee wanted to know the present position of the case reported in the Audit para. The Department of Revenue and Insurance, in a note furnished to the Committee, stated: "The Audit objection has not been accepted. However, as a precautionary measure, the assessments for 1968-69, 1969-70 and 1970-71 have been reopened under Section 147(b). The assessment for 1967-68 could not be reopened as the period of limitation had already expired."

5.95. The Committee enquired whether the Ministry/Board had statistical data regarding the number of companies|firms doing chit fund business. The Ministry, in a note, stated: "The Board does not have any statistical data regarding the number of companies/ firms|individuals doing chit funds business all over India. However, the number of chit companies/firms doing business in the Union Territory of Delhi about the end of 1972 was 121."

5.96. When asked whether the Ministry had considered desirable to issue suitable instructions to all Commissioners of Income-tax so that proper assessment of chit fund companies were made uniformly, the Ministry stated: "The audit objection has not been accepted.

However, the point raised by audit would be studied in greater detail with reference to a few cases and suitable instructions would be issued, if necessary, in consultation with the Ministry of Law so that uniform practice is followed in dealing with this issue in all cases.

5.97. In Audit's view the dividend accrued in respect of vacant chits subscribed to by the company engaged in chit fund business are to be treated as income for the purpose of income-tax assessment of chit funds as it is not notional but real income. The Committee have been informed by the Ministry that the point raised by Audit would be studied in greater detail and suitable instructions issued, if necessary, in consultation with the Ministry of Law. It is well-known that in the past few years many chit funds companies have sprung up in almost all the States in the country. The number of such entities in the Union Territory of Delhi alone was 121 at the end of 1972. It is, therefore, necessary that the Central Board of Direct Taxes should complete their study of the accounting of these chit funds very expeditiously and issue instructions for proper computation of income of the funds so that the levy of income-tax is made uniformly and in the best interests of Government. The working of the chit funds should also be studied in depth because there is good reason to suspect that not all of them keep away from mal-practices which go against the interests of those who invest their funds in them.

CHAPTER VI

OMISSION IN LEVY OF SUR-TAX AND SUPER-PROFITS TAX

Audit Paragraph

6.1. A company whose chargeable profits for an assessment year exceed the statutory deductions, is liable to pay sur-tax under the Companies (Profits) Sur-tax Act, 1964. Income-tax assessments of a company for the assessment years 1966-67 and 1967-68 were completed but there was omission to levy sur-tax of Rs. 52,773, on the chargeable profits of the company exceeding the statutory deductions by Rs. 1,65,760 during these two years.

6.2. The Ministry have reported (November, 1972) that the assessment in question have been revised and the additional tax collected.

[Paragraph 22(i) of the Report of the Comptroller and Auditor General of India for the year 1971-72, Union Government (Civil), Revenue Aeceipts, Volume II—Direct Taxes].

6.3. The Committee learnt from Audit that the assessee did not voluntarily file a sur-tax return as required under Section 5(1) of the Companies (Profits) Sur-tax Act, 1964 nor the Income-tax Officer called for the same under Section 5(2) *ibid.* The Income-tax Officer did not initiate action under Section 8(a) to assess the company to sur-tax for these two assessment years.

6.4. The Committee wanted to know whether there were any instructions that sur-tax assessments should be completed immediately after the Income-tax assessment of an assessee was completed, if so, the reasons for not complying with those instructions. The Department of Revenue and Insurance in a note furnished to the Committee, stated: "Instructions have been issued in October, 1969 to ensure an up-to-date finalisation of sur-tax assessments consequent upon the completion of the relative income-tax assessments. The Income-tax Officer has explained that as per original assessment for the assessment year 1966-67 completed on 21st February, 1970 there was no liability to sur-tax. The assessee was treated as non-industrial company. There was no question of levying of any sur-

tax as the chargeable profits after deducting tax at the higher rate of income-tax of 65 per cent applicable to a non-industrial company was below the statutory limit of Rs. 2 lakhs. For the assessment year 1967-68, sur-tax liability was attracted as per original assessment. However, the Income-tax Officer did not initiate the sur-tax proceedings immediately because there was a dispute regarding the rate of tax applicable to the company. As the Income-tax Officer had treated the assessee as a non-industrial company a rate of 65 per cent was applicable for charging income-tax. The assessee had filed an appeal and had claimed a lower rate of tax at 55 per cent. If the decision was in assessee's favour, the chargeable profits would have gone up with a consequential increase in sur-tax. The Income-tax officer therefore waited even for the assessment year 1967-68 for the result of the appeal before initiation of sur-tax proceedings. The case was audited by Revenue Audit on 14th July, 1967. By that time the Appellate Assistant Commissioner had decided the appeals for both the years on 3rd November, 1970 and had held that the company was an industrial company and was liable to income-tax @ 55 per cent. Thus, the company became liable to sur-tax for the assessment year 1966-67 only after the AAC's order. It was in these circumstances that the Income-tax Officer did not complete the sur-tax assessments immediately after the completion of the income-tax assessments. He could have acted earlier and his explanation has not been accepted as satisfactory."

6.5. When enquired whether any penalty proceedings had been initiated against the assessee for his failure to file the sur-tax return voluntarily, the Ministry, in a note, replied in the affirmative. They further added: "Notices u|s. 9(a) of the Sur-tax Act have been issued on 16th March, 1972 for late filing of the sur-tax returns for the two years."

6.6. The Committee wanted to know the number of cases wherein assessees had not filed sur-tax returns voluntarily and out of these cases, the number of cases where penal proceedings had been initiated. The Ministry, in a note, stated: "The information for the assessment year 1972-73 is being collected and a further report will follow."

6.7. In this case neither the assessee filed voluntarily a sur-tax return nor the Income-tax Officer called for it and no action was taken to assess the company for two years till Audit pointed it out. The explanation for this lapse on the part of the ITO is admittedly unsatisfactory. The Committee had already pointed out in paragraph 6.7 of their 88th Report (Fifth Lok Sabha) that the ITOs had tended to give sur-tax assessments a low priority. They had also

stressed that sur-tax assessment should be taken up alongwith the connected assessments of income-tax of the companies. Government should ensure that this recommendation is implemented in letter and spirit.

6.8. Another unsatisfactory feature of this case is that the ITO did not initiate penalty proceedings against the assessee for his failure to file the sur-tax return until as late as 16th March, 1972. The Committee cannot but deprecate such laxities. They trust that the Board will issue strict instructions to the assessing officers in this regard. They would await a report regarding the number of cases wherein the assessees had not filed sur-tax returns voluntarily, the number of cases where penal proceedings were not initiated and the present position of each of these cases.

CHAPTER VII

OTHER TOPICS OF INTEREST

Audit Paragraph

7.1. The computation of insurance business income is governed by special provisions of the Income-tax Act, 1961 under which dividend income included in the insurance business income loses its identity as dividend, and is treated as business income irrespective of its source, and the concessional rate of tax for inter-corporate dividends is not admissible.

7.2. However, concessional rate of tax was charged in respect of dividend income included in business income in 75 assessments involving 26 insurance companies, resulting in aggregate undercharge of tax of the order of Rs. 23,96,510 for the assessment years 1964-65 to 1970-71.

[Paragraph 24 of the Report of the Comptroller and Auditor General of India for the year 1971-72, Union Government (Civil), Revenue Receipts, Volume II—Direct Taxes].

7.3. Under the Income-tax Act, 1961, the income of insurance business is not computed in accordance with the normal provisions of the Act, but according to a special method laid down in the Schedule. As regards general insurane business under this special method the profit disclosed in the annual accounts furnished by the company, to the Controller of Insurance, is taken to be the income of the previous year. The position under the Income-tax 1922 was also the same.

7.4. The Committee were given to understand by Audit that it was held by Privy Council, in 1948 (C.I.T. *Vs* Western India Life Insurance Co.) that since the income of an insurance business was assessed on notional basis, and was not the actual income computed under the Act, the exemptions otherwise admissible under the law would not be available. This decision was cited with approval by Supreme Court in 1965 (Vanguard Fire and General Insurance Company *Vs.* C.I.T.) in the case of a general insurance company. The Supreme Court held that relief for newly constructed house for

computation of income from house property is not available to a general insurance company, because so far as general insurance business is concerned there is no income under the heads 'income from house property etc.'

7.5. Subsequently, however, Bombay High Court held in 1961 that despite the fact that the income of insurance business is computed under special provisions, the reliefs are admissible.

7.6. The Central Board of Direct Taxes had earlier issued instructions in 1964 that reliefs should be allowed.

7.7. In this case, the objection is based on the view taken by the Supreme Court and earlier by Privy Council. The Ministry had not accepted the objection on the authority of the High Court decision.

7.8. The Committee wanted to know the number of cases wherein the undercharge referred to in the Audit para had occurred, and out of them the number of foreign insurance companies. They also desired to know the total tax paid by all the foreign insurance companies during the year 1971-72 and the total amount of profit remitted by these foreign insurance companies, out of India. Department of Revenue and Insurance, in a note furnished to the committee, stated: "The undercharged mentioned in audit para, has occurred in 26 cases. Of these, 21 are foreign companies and five are Indian companies. Information regarding the total tax paid by all these foreign companies during the year 1971-72 is not readily available. It will be collected and supplied later on. Information relating to the total amount of profit remitted by these foreign companies is also not readily available. Details will be collected and supplied when received."

7.9. The Committee wanted to know the ratio of the Privy Council decision of 1948 in the case of Western India Life Insurance Company. The Ministry, in a note, stated: "Western India Life Insurance Co. Ltd., was a company doing only life insurance business. Its assessments for the assessment years 1939-40 and 1940-41 were made in accordance with the provisions of Sec. 10(7) of Income-tax Act, 1922, under Rule 2(b) of the First Schedule of the said Act. The annual average of the surplus disclosed by the acturial valuation made for the last inter-valuation period, *viz.*, the triennial period, ending 31-12-1938 was assessed as the income for these two assessment years.

7.10. The assessee owned certain securities outside British India. In accordance with the third proviso to Sec. 4(1) of the Income-tax Act, 1922, the assessee claimed a deduction of Rs. 4500|- out of

its income accruing outside British India and not remitted into British India. The Privy Council rejected the claim on the ground that the third proviso to Sec. 4(1) had no application since the income therein referred to must be the actual income of the year in question and not a notional income arrived at by computing an average income by reference to the income of the other years. It could not be said that there had been included in the assessment of the income of that year any part of the actual income of the year, whether derived from foreign investments or otherwise'. Their Lordships found it 'impossible to apply the words of the third proviso to Sec. 4(1) to assessment under Rule 2(b) of the Schedule'."

7.11. When enquired whether the decision of Privy Council was taken into account while issuing the Circular No. 15D (xxx ii-10) of 1964 dated the 17th June 1964, the Ministry, in a note, stated: "The Board's file on which the circular No. 15.D (xxxiii 10) of 1964, dated 17-6-64 was issued is not readily available. However, it will be noticed that the Privy Council's decision has no application to the assessment of general insurance companies where Rule 2(b) has no application. Under Rules 5 and 6 of the First Schedule of the Income-tax Act, 1961, in the case of general insurance companies, the income assessed is the actual income of the pervious year and not a notional income as is the case with Life Insurance Companies assessed under Rule 2(b) of the First Schedule of the Income-tax Act, 1922."

7.12. The Committee asked whether the position was reviewed in the light of the Supreme Court judgement of 1965 in the case of Vanguard Insurance Co. Ltd.

7.13. The Committee also pointed out that it appeared that the Board had issued instructions [item 18 of Statement 'C' attached to the Board's Circular No. 91|40|65-ITJ dated 17-9-1968] with the following observation:

> "Applying the ratio of the Supreme Court's decision in the case of Banguard Insurance Company (60 ITR 496) the Board is of the view that in computing the income of insurance business....exemption available under the Notification issued under Section 60 cannot be extended to the assessee."

7.14. The Committee wanted to know, if the Board still held the above view, what was the difficulty in accepting the contention of Audit in the present Audit para. The Ministry, in a note, stated: "The Supreme Court's decision in the case of Vanguard Fire and

General Insurance Co. dealt with the admissibility of deduction u/s. 4(3) (xii) of the Income-tax Act, 1922, in the assessment of general insurance business. Sec. 4(3) (xii) reads as under:

> 4(3) Any income, profits or gains falling within the following clauses shall not be included in the total income of the person receiving them....
>
> (xii) Any income chargeable under the head 'income from property' and in respect of a building, the erection of which is begun and completed between the first day of April, 1946 and the 31st day of March, 1956, both days inclusive for a period of two years from the date of such completion.'

The ratio of the decision is 'It is equally impossible to apply the provisions of Sec. 4(3) (xii) to an assessment under section 10(7) read with paragraph 6 of the schedule. There is no income chargeable under the head 'income from property' as far as general insurance business is concerned. The effect of Section 10(7) is to delete the heads 'Interest on Securities', 'Income from Property' and 'Income from other sources' from Sec. 6 of the Act, as far as general insurance businesses are concerned.

Briefly, the ratio of the decision is that in the case of General insurance business, there is no income *chargeable under the head 'Income from property'* and that, therefore, the exemption under section 4(3) (xii) is not available.

The concessional rate of tax u|s. 99(1) (iv) and 85-A and the deduction u|s. 80-M are available to a company by virtue of the fact that the income derived is income from dividend. For the purpose of such concessional rate or deduction, it is not necessary that the dividend received by the company should be *chargeable* under the head 'Income from other sources'. Consequently, the Supreme Court's decision in the case of Vanguard Fire & Gen. Insurance Co., did not make any change in the position of law laid down in the circular No. 15-D of 1964, and, therefore, there was no need to review the circular.

In the case of Lakshmi Ins. Co. Ltd. the Delhi High Court has taken the view that the assessee is entitled to exemption under a notification issued u|s. 60 of the Income-tax Act, 1922, in respect of 'Interest on Securities' of the Mysore Government. The Board did not accept this judgement and filed a leave petition for appeal to

the Supreme Court. However, on the advice of Ministry of Law, this petition was subsequently withdrawn. The observation under item 18 of statement 'C' attached to Board's circular No. 91|40|65-ITJ, dated 17th September, 1968, should be considered as having been modified in the light of the advice of the Ministry of Law, according to which the leave application was withdrawn."

7.15. According to Audit the concessional rate of tax for inter-corporate dividend is not admissible to the insurance companies. The computation of insurance business income is governed by special provisions of the Income-tax Act, 1961. The provisions of the Act relating to the computation of income chargeable under heads "interest on securities", 'income from other sources" etc., shall not apply to the computation of profits on insurance. The Ministry are of the view that for the purpose of concessional rate it is not necessary that the dividend received by the company should be chargeable under the head 'income from other sources". The Committee find that even though Section 80(M) does not deal directly with computation of income "under other sources" it deals with deduction in respect of certain inter-corporate dividends from gross total income. The rules in the First Schedule are quite comprehensive and where it is intended to give a specific deduction, such deduction is mentioned notwithstanding that the same deduction is separately provided for in the general computation sections. It appears that in the absence of a specific provision in the First Schedule itself, the inter-corporate deduction was not intended to be permitted. However, as the matter is not fre from doubt, the Committee desire that a competent legal opinion should be obtained in view of considerable tax effect involved.

NEW DELHI;
19th *April*, 1974
29th *Chaitra* 1896 (*S*)

JYOTIRMOY BOSU,
Chairman,
Public Accounts Committee.

APPENDIX

Summary of Main Conclusions/Recommendations

Sl. No.	Para No. of the Rept.	Ministries/Deptt. concerned	Conclusions/Recommendations
1	2	3	4
1	1.7	Finance (Rev. & Ins.)	The omission to levy additional tax at the rate of 7.5 per cent on equity dividend declared or distributed by the companies for the assessment year 1968-69 in the two cases mentioned in the Audit paragraph resulted in short-levy of tax amounting to Rs. 1.85 lakhs. This looks tobe a 'tip of an iceberg'. Year after year a number of such cases have been brought to the notice of the Committee through Audit Reports. The Audit Report, 1970-71, mentioned 8 such cases involving under-assessment to the extent of Rs. 10.17 lakhs. The Committee take a very serious view of repetitive failures of this kind in the Company Circles particularly as they are manned by senior and experienced officers. The Committee are of the view that disciplinary action is called for against officers including the supervisory officers who are found to have been negligent in the discharge of their duties.
2	1.8	-do-	The Committee learn that the Ministry have ordered a review of the assessment of the companies for the assessment years 1964-65 to 1968-69 and that the results so far available indicate ommissions to

			levy additional tax in 15 cases. It would have been more satisfactory had this review been conducted by the IAC(Audit). The Committee await the final outcome of the review which they trust would be followed up immediately by action to recover additional tax due in respect of under-assessments that are detected.
3	1.15	-do-	In this case, rebate of super-tax was allowed at the rate of 30 per cent instead of 20 per cent admissible under the Finance Act 1964, in the original assessment made on 9th October, 1968. Strangely enough the mistake was repeated while giving effect to an appellate order on 18th January 1971. When a mistake of this kind is repeated in a case which was specifically assigned to the Central Circle owing to suspected tax evasion it cannot but cause concern and arouse suspicion in the mind of the Committee. A proper inquiry should, therefore, be carried out and appropriate action taken against officers found to be responsible.
4	1.16	-do-	The internal Audit had pointed out the mistake in this case on 17th December, 1970 and had there been the intention it could have been easily rectified while giving effect to the appellate order on 18th January 1971. Regrettably no action was taken to rectify the mistake till 27th November 1971 when the case was taken up by the Revenue Audit. The Committee had taken note of the very unsatisfactory position in regard to rectification of mistakes pointed out by Internal Audit Parties in paragraph 2.27 of their 51st Report (Fifth Lok Sabha). The explanation given by the Ministry for the delay in taking action to rectify the mistake pointed out by the In-

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			ternal Audit in this case brings out another unsatisfactory feature of the working of the Department. There have been as many as five changes of ITOS in relation to this case during a period of less than 8 months (1-4-71 to 27-11-71). Such frequent changes are obviously undesirable; as they cannot but result in inefficiency, they should be avoided in future. In this connection the Committee would recall their observation contained in para 2.331 of their 51st Report.
5	1.28	Finance (Rev. & Ins.)	Although 'income' as defined under Section 2(24) includes capital gains chargeable under Section 45, in this case mysteriously enough capital gains were omitted while calculating the average rate of tax on total income, for the purpose of allowing rebate on inter-corporate dividends for the assessment year 1965-66. It creates suspicion that despite clear instructions from the Board that the ITO should personally recheck tax calculations of demands in cases with income over Rs.1 lakh, no check had been carried out in this case which involved a total income of as high as Rs. 221 lakhs. In his explanation for the failure to carry out the checking, the ITO has stated that the IAC had given an assurance that the ITOs would not be held responsible for any mistakes in the calculation of tax. Although the explanation has not been accepted, the Committee consider it desirable to ascertain whether any assurance of this nature had been given by the IAC concerned and if so why he had

			done so. The Committee should be informed of the result of such an inquiry.
6	1.29	-do-	The Committee find that the CIT has been asked to carry out a selective review with a view to finding out if similar mistakes have been committed. They stress that this review should also be extended to seeing whether the ITOs in this charge have been rechecking the tax calculations as per the Board's instructions. The review should be conducted by the IAC (Audit). The Committee would await the results of the review.
7	1.48	-do-	Under the Finance Act, 1964 and 1965, certain deductions had to be made from the super-tax rebate and the deduction was limited to the extent of the rebate and the balance was to be carried forward. Failure to carry forward the deduction in this case resulted in short-levy of tax of Rs. 1.33 lakhs in the assessment year 1965-66. Similar provisions were there in the Finance Acts, 1956 to 1959. The Committee had called for a general review as early as 1964-65, in view of the fact that the lapses in computing super-tax were on the increase. This suggestion was reiterated by them subsequently during 1968-69 and 1972-73. Finally the Committee are informed that as a result of a review of company assessment cases completed during the period 1964-65 to 1967-78, under-assessment of tax to the tune of Rs. 6.96 lakhs has been noticed out of which Rs. 5.86 lakhs are to be treated as a loss of revenue as the cases are outside the time-limits for rectificatory action. The Committee cannot but deplore

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			the fact the review ordered from time to time was not carried out effectively and expeditiously. The Committee desire that responsibility should be fixed for this failure, which has resulted in a substantial loss of revenue. They would await the result of the action taken.
8	1.49	Finance (Rev. & Ins.)	In view of what has happened, the Committee stress that every company assessment should be checked immediately by the Internal Audit after the ITO's assessment so that mistakes can be rectified within the limitation period.
9	1.50	-do-	The Committee have been informed that in the present case, the ITO did not have before him the folder for the preceding year where the carry forward of the rebate which was to be withdrawn had been recorded. There was also no note on this point. The Committee stress that suitable instructions should be issued to the assessing officers so as to ensure that mistakes of his kind do not recur in future.
10	1.73	-do-	Under the provisions of the Income-tax Act, if a company in which the public are not substantially interested, fails to distribute the prescribed percentage of its distributable income as dividends such a company is liable to pay additional super-tax. For the assessment years prior to 1965-66, shares of a company held by another company in which public are substantially interested are not to be treated as held by public. In this case additional super-tax of

			Rs. 8.79 lakhs was not levied for the assessment year 1959-60 as the company was incorrectly classified as one in which the public were substantially interested. Mistakes of this type have been brought to the notice of the Committee earlier also. The Committee, would, therefore, call for a review of all the completed assessments relating to the assessment years prior to 1965-66 for appropriate action. The results of the review should be intimated to the Committee.
11	1.74	-do-	The Committee note that the Chief Auditor of the Internal Audit is expected personally to audit certain important types of cases and one such category of cases is related to cases involving 'liability to additional tax by companies in which the public are not substantially interested'. The Committee desire that the criteria for determining whether the public have or have not substantial interest in a company should be clearly laid down in the I.A. Manual. In this connection the committee suggest that the question how far a foreign company could be treated as one in which public are substantially interested may also be examined in consultation with the Ministry of Law.
12	1.75	-do-	The Committee had, in paragraph 2.74 of their 51st Report (Fifth Lok Sabha), suggested an examination of the feasibility and economics of dispensing with the subtle distinction between a public company and a closely held public company for the purpose of taxation of profits. According to the Chairman, Central Board of Direct Taxes, the distinction is necessary because it is not difficult for private companies to be registered as or to change themselves into

1	2	3	4
			public companies if they want to escape the rigours of taxation. The Committee understand that there is an attempt to meet this situation in the new company Law (Amendment) Bill. They accordingly wish to reiterate that the question of doing away with the distinction between a public company and a closely held public company should be considered expeditiously as a step towards simplification.
13	2.13	Finance (Rev. & Ins.)	The Committee are distressed to note the sheer carelessness if not something else on the part of the ITO resulted in short-levy of tax to the extent of Rs. 2.19 lakhs in this case. The ITO failed to notice that a capital expenditure of Rs. 3.96 lakhs was included under "miscellaneous expenditure" in the assessee's claim of deductions. He did not make a proper study of the company's balance sheet. What is worse was that even after the receipt of Audit objection he did not care to rectify the mistake for 15 long months. The Committee have been informed that as the officer was responsible for a few more lapses, a thorough enquiry has been ordered. The Committee stress that the cases should be thoroughly investigated and the result of investigation and action taken against officials found to be at fault intimated to them within six months.
14	2.14	-do-	Another distressing feature of this case is the failure of the Internal Audit to highlight the mistake. The Committee understand

			that an Upper Division Clerk has been warned in this connection. They wonder how the case involving a total income of Rs. 1.87 crores could be entrusted to a UDC only for check. It is clear that higher officers should also share the blame and their responsibility should be fixed. This arrangement for Internal Audit seems to be wholly unsatisfactory. This reveals serious weakness and unsuitability of the present system. The Central Board of Direct Taxes should look into this aspect immediately and ensure that high income cases are invariably checked thoroughly at appropriate level.
15	2.19	-do-	The Committee are concerned to note that the ITO failed to add back to the net profits disclosed in Profit and Loss Accounts of the company the losses relating to certain contracts which were not accepted by him. This failure resulted in under-assessment of tax to the extent of Rs. 6.32 lakhs and short-levy of penal interest under Section 215 to the extent of Rs. 1.21 lakhs. The Committee desire that the officer should be suitably taken to task for this costly lapse. They would await a report regarding recovery of the additional tax. They would further suggest that other assessments completed by this ITO should be audited.
16	2.20	-do-	Although the assessment was checked by the Internal Audit Party, the mistake was not pointed out by them. The failure to detect even this simple mistake is indeed deplorable. This is indicative of lack of thoroughness on the part of the Internal Audit in exercising check. The Committee have time and again pointed out instances of this type which ought to be taken serious note of by

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			the Ministry. Besides bringing to book the official found negligent, the Ministry should undertake a comprehensive review of the entire working of the Internal Audit in consultation with Revenue Audit to bring about qualitative improvement. In this connection they would refer to their observations contained in paragraph 2.30 of their 51st Report (Fifth Lok Sabha). In view of the urgency of the matter, the Committee emphasise that necessary action should be taken with utmost speed and reported to them.
17	2.29	Finance (Rev. & Ins.)	The Committee regret that in this case the assessee's computation of income claiming relief for priority industry without deduction of the development rebate was accepted for three assessment years which resulted in a short-levy of tax of Rs. 3.01 lakhs. The non-inclusion of development rebate was not noticed by two ITOs who dealt with the assessments. The Committee desire that apart from taking suitable action against the ITOs, a test check should be conducted to see if similar mistakes were committed. The Committee consider a test check is very necessary because they have come across mistake of this type earlier also *vide* para 2.193 of the 51st Report (Fifth Lok Sabha).
18	2.30	-do-	The Committee learn that the assessee has filed a writ petition challenging the proceedings initiated under Section 154 to rectify the mistake, *inter alia*, on the ground that "the alleged mistake, if

			any, is not a mistake apparent from the records." The Committee would await the outcome of the writ. In the meanwhile, they would like the Ministry to examine whether any amendment to the Act is necessary to ensure that rectification of patent mistakes is not frustrated by assessees seeking legal remedies on mere technical grounds.
19	2.41	-do-	In computing taxable income from the business of manufacture of sugar, the market value of sugar-cane raised by the factory on its farm and used in the manufacture of sugar is deductible under the Rules as it relates to agricultural operations. Consequent on the retrospective increase of market price of sugarcane in the working seasons of 1958-59 and 1959-60 by an order dated 24-12-1964, the assessee filed revised returns for the relevant assessment years *viz.* 1960-61 and 1961-62, in which additional amount of Rs. 5,12,290 was claimed as deduction. This was allowed in the revised assessments completed on 14-3-1968. In the meanwhile, the assessee filed the return for the assessment year 1966-67 on 8-8-1966 wherein the same amount of Rs. 5,12,290 was deducted from total income which was also allowed by the ITO. The deduction allowed twice had a tax effect of Rs. 2.9 lakhs. The ITO, who completed the assessment for the year 1966-67, appears to have been grossly negligent in that. He failed to do something which was clearly his duty to do, namely to scrutinise properly the loss of Rs. 6.72 lakhs returned by the assessee. As the assessee must have given the reasons for the deduction it should have been possible for the ITO to have linked it up with the revised assessments for the years 1960-61 and 1961-62.

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			The Committee require that appropriate inquiry and action should be initiated. They further suggest that other assessments completed by this ITO should be audited.
20	2.42	Finance (Rev. & Ins.)	According to the Ministry, the correct legal position appears to be that the liability for the additional price arose on 22nd December 1964 when the order of the Sugarcane (Additional) Price Fixation Authority was passed. It would, therefore, seem to be not correct to have reopened the assessments for the assessment years 1960-61 and 1961-62, in this case. The Committee would like to know how the enhanced price stated to have been paid by the assessee in regard to purchases from open sources was dealt with in the relevant assessments. The Committee further desire that the correct position in law should be clarified for the guidance of the officers concerned.
21	2.43	-do-	The Committee find it somewhat difficult to understand the circumstances which could have led Government to come to the conclusion that it was necessary to revise the price of sugarcane retrospectively after a period of nearly 6 years and how such a revision could possibly have subserved the interests of the producers of sugarcane and the general public.
22	2.44	-do-	Incidentally the Committee find that in this case the assessment

for the year 1966-67 was completed on 22-3-1971 when it was about to become time-barred. The rush of assessment at the end of the limitation period may often lead to mistakes of a costly nature as in this case being committed. It is regrettable that frequent changes in the ITOs continue to take place. The Committee have earlier in this Report expressed their dissatisfaction over such frequent changes which must necessarily affect the work of the Department adversely.

23	2.58	-do-	In this case the assessee submitted a revised return in December, 1963 reducing the income by taking into account the debit of Rs. 1.43 lakhs representing the cost of bonus shares received from another company, purporting to follow a High Court judgement. This judgement was delivered by the High Court on 28-11-1960. The decision of the Board in not accepting the High Court judgement was contained in the bulletin for the quarter ending 30-9-1961 which was circulated to all the officers. The I.T.O. must have, therefore, been aware of the position. Yet he did not ascertain as to what happened to the further appeal preferred against the High Court judgement nor did he keep a note to facilitate revision of the relevant assessment. In the meantime, the High Court judgement was reversed by the Supreme Court in March, 1964. Unfortunately by the time Supreme Court judgement was communicated, the ITO had left on deputation and his successor was not aware that he had completed the assessment in question following the judgement of the High Court. To say the least, all this indicates a very unsatisfactory system of working. The Committee desire that the lapses on the part

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			of the ITO should be carefully gone into for appropriate action under advice to them and suitable instructions should be issued promptly to all the assessing officers with a view to preventing lapses of this kind.
24	2.67	Finance (Rev. & Ins.)	Under the Income-tax Act, exemption is admissible to the profits and gains derived from a newly established industrial undertaking to the extent of 6 per cent of the capital employed in such undertaking. Where they fall short of 6 per cent, carry forward of deficiency was admissible only from the assessment year 1967-68. However, in this case a deficiency of Rs. 2.58 lakhs for 1966-67 was allowed to be carried forward which resulted in a total undercharge of tax of Rs. 1.42 lakhs for the assessment years 1967-68 to 1969-70. The Committee learn that the CIT has been asked to direct the IAC to carry out an inspection of the concerned ITOs work. The Committee would await a report in this regard.
25	2.68	-do-	The Committee incidentally note that during the financial year 1971-72 in all 337 new undertakings were granted 'tax holiday' relief under Section 80J. Unfortunately the Department is not in a position to indicate the number of such undertakings which fall in small scale sector. It would be of interest and value to know the number of undertakings in the small scale sector, which benefited from this concession and the Committee trust that the Ministry will

take suitable steps to ensure that this information is readily available. In this connection the Committee would recall their suggestion contained in paragraph 7.15 of their 87th Report (Fifth Lok Sabha).

26 3.32 -do-

M|s. Oil India Ltd., a joint venture of Government of India and Burmah Oil Company incorporated on 18th February, 1959, took over the assets of Assam Oil Company Ltd., a subsidiary of Burmah Oil Company. The Committee are not happy over the manner in which tax concessions have been granted purported to be in accordance with an agreement dated 27th July, 1961, to M|s. Oil India Ltd., the benefit of which partly went to a foreign multinational Corporation which is against national interest. It is evident that the implications of the various provisions of this agreement in relation to taxation had not been carefully and properly scrutinised before they were finalised. The following points arise out of the Committee's examination of the matter.

(i) The agreement provided that in respect of the expenditure of Rs. 916.56 lakhs on certain assets taken over by M|s. Oil India Ltd., amortisation over a period of 15 years at the rate of Rs. 61 lakhs per annum would be allowed from the assessment year 1963-64 onwards. This was purported to be done under Section 42 of the Income-tax Act, 1961. Under this Section a provision for amortisation of expenditure on drilling or exploration activities could be made by agreement only if such expenditure were "expenditure incurred by the assessee".

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			It was, however, not the case here and therefore the allowance would constitute an extra legal concession resulting in huge loss of revenue. (ii) In terms of the agreement, in respect of the expenditure (Rs. 161.04 lakhs) on building, plant and machinery "usual depreciation/development rebate" should be allowed each year as per the Income-tax Act. Under this provision the company was allowed development rebate on the pre-incorporation expenditure on building and machinery to the extent of Rs. 33.04 lakhs for the assessment year 1960-61 by the ITO under instructions from the Commissioner. Under the Income-tax Act, however, the grant of development rebate is subject to the condition that the plant and machinery should be new and that it is admissible only in respect of the year of installation. The Committee were informed that there was no intention of giving any development rebate in relaxation of the basic provision of the law. The plant and machinery taken over from the Assam Oil Co. were not new and were also not installed in the relevant previous year 1959-60. It seems that substantial portion thereof must have been installed even prior to 1954 when the provision for development rebate became effective in the Income-tax Act. Further, it remains to be confirmed whether in

respect of assets installed between 1954—58, the Assam Oil Co. itself was allowed development rebate in its assessment. Although the Board was associated with the drafting of the relevant clauses of the agreement relating to taxation, it was not pointed out that this concession was ouside the scope of the Act which, as felt by the Finance Secretary, should have been done. Further, it is unfortunate that even when the Commissioner made a reference to the Board, the Board did not examine the matter properly and find out whether the development rebate on these assets were admissible to M|s. Oil India Ltd. Only now is it proposed to consult the Ministry of Law in the matter. There does not appear to have been any justification for allowing such extraordinary and extra legal concessions.

(iii) In addition to the development rebate on plant and machinery, a sum of Rs. 26.80 lakhs was also allowed as development rebate on "casing and tubing", costing Rs. 107.20 lakhs in the assessment year 1960-61. This cost was, however, included in the expenditure of Rs. 916.56 lakhs which was allowed to be amortised over a period of 15 years. Although a view was initially held that "casing and tubing" was not plant and machinery and hence no development rebate would, in any case, be admissible thereon, it was allowed under the instructions

of the Board without making any reduction in the amortisation allowance. Even if it is regarded as plant and machinery it is doubtful whether development rebate would be admissible in view of what is stated in item (ii) above. The Ministry of Finance have promised to take up the matter again with the Ministry of Law.

(iv) An indirect consideration was passed on to Assam Oil Co. for a period of 20 years by Oil India Ltd. by way of supply of oil and associated natural gas at a concessional rate ranging between 50 per cent to 60 per cent of the normal sale price. The Committee understand that the benefit of this concession is estimated at Rs. 9 crores. It is not clear whether the entire assets of Assam Oil Company had been taken over on the basis of the market value. It should, therefore, be examined from the angle of capital gains tax, in consultation with the Ministry of Petroleum and Chemicals and Ministry of Law, whether in view of the substantial concession there was undervaluation of the assets.

27	3.33	Finance (Rev. & Ins.)	In view of the fact that the quantum of concessions is very large and it is not free from doubt to what extent they were given by Government as a matter of policy or to what extent they are in

			accordance with the law, the Committee consider it essential that there should be a thorough enquiry into the matter immediately for appropriate action including revision of the relevant assessments of the company to the extent that is legally permissible. Responsibility for the failure/lapse of the C.B.D.T. as brought out in items (ii) and (iii) should also be fixed for such action as may be called for.
28	3.34	-do-	The Board should also have an effective machinery for proper scrutiny of the taxation aspects of such agreements before they are finally entered into by the Government of India.
9	3.48	-do-	Under the Income-tax Act, an assessee who avails himself of the concession of development rebate should keep 75% of the development rebate in a separate reserve account and should not utilise the same for distribution as dividends or for remittance outside India as profits for a period of 8 years. If this direction is not followed the development rebate already granted, is liable to be withdrawn. The Committee note with concern that in the case of a number of assessments relating to two companies the ITO did not take any notice of the fact that the development rebate reserve had been utilised for declaration of dividend or having noticed the fact, failed to take necessary action open to him. This failure resulted in a short levy of tax to the extent of Rs. 8.81 lakhs, and excess computation of business loss of Rs. 6.31 lakhs. The Committee find that in these companies the non-resident share-holding is substantial. They further find with concern that a recovery of under-charge of Rs. 5.04

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			lakhs from one of the companies has become time-barred. They cannot but take a serious view of the substantial loss to Government. Surprisingly, no action seems to have been taken against the ITOs concerned excepting that they were informed that their explanations were found to be not acceptable.
30	3.49	Finance Rev. & Ins.	As no extenuating circumstances appear to exist, the Committee consider that appropriate disciplinary action should be taken against them and the Committee informed.
31	3.50	-do-	It is most distressing that the assessments for 8 years in the case of one company and for two years in the case of another company were not checked by Internal Audit despite instructions issued by the Board in 1965 that all company assessments should be checked cent-per-cent. The check of the only assessment carried out by them did not bring to light the mistake. This yet another instance of the inefficiency and inadequacy of the Internal Audit. The Committee are unable to accept the plea that the strength of the Internal Audit Parties was not adequate to complete the volume of work within a reasonable time. What is necessary is the manning of Internal Audit Parties with competent and trained personnel at a fairly high level. The Committee would like this aspect to be examined urgently and suitable action taken thereafter without loss of time. Meantime, the Committee note that recently the Board have laid down priorities for the work of the Internal Audit so that

			cases with considerable revenue effect get foremost attention and trust that the Board will ensure that at least these instructions are strictly adhered to by the Internal Audit.
32	3.51	-do-	The Committee would await the outcome of the departmental appeal before the tribunal in the case of one of the companies.
33	3.61	-do-	Sub-section (1) of Section 43A of the Income-tax Act provides that where a part of payment towards the cost of assets purchased in foreign countries is yet to be made and the liability on account of such outstanding payments goes up due to devaluation of the Indian currency, the assessee can write up the cost on such assets in his books for purposes of claiming depreciation etc. However, sub-section (2) specifically prohibits allowance of development rebate on the increase in cost of assets on account of devaluation. Nevertheless, in the cases of no less-than three companies excess development rebate was allowed due to non-observance of this provision. The Committee regret that mistakes (if they were mistakes at all) of this type should have occurred in a Company Circle where the ITOs handled assessments of a few important companies only. The Committee learn that the cases of the two officers who handled these assessments havee been referred to the CBI for investigation. They desire that the investigation should be carried out with all speed and the results as well as the action taken against the officers reported to them.
34	3.62	-do-	The Committee further find that the two companies had claimed development rebate on the increased cost of machinery due to devaluation and that as the revision of the assessment was done

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			under Section 154 no penalty proceedings were initiated. The Committee desire that the question of prosecution should be examined expeditiously and the action taken intimated to them.
35	3.63	Finance Rev. & Ins.	The Committee have received an impression that the cases of depreciation and development rebate allowed by the ITOs are not being checked properly despite the instructions issued by the Board from time to time. In this connection they would refer to their observation contained in paragraph 2.148 of their 51st Report regarding carrying out of a check of such cases by the IAC's. Further, although the instructions to the Internal Audit Party were that in cases of depreciation and development rebate of over Rs. 25,000, calculations would be checked by an ITO posted as Officer-on-Special Duty, the cases mentioned in the Audit paragraph had not been checked by him. The plea of heavy work-load is totally unacceptable as it was upto the Government to see that proper arrangements are made so as to ensure effective compliance of their instructions. The Government should carefully assess the work-load keeping in mind the quality aspect of the work-load and take steps to have adequate staff. The Committee expect Government to see to it that their instructions are enforced efficiently and expeditiously.
36	3.75	-do-	The Audit paragraph brings out incorrect computation of the extra shift allowance for double and triple shift working of plant

			and machinery in the cases of two companies. Under the Rules 50% of the normal depreciation is allowed for each of the double and triple shifts. Very strangely, however, in the case of one company extra shift allowance at 100% of the normal depreciation was allowed for the triple shift working of the machinery in addition to extra shift allowance @ 50% for the double shift. In the case of another company, extra shift allowance for the double shift working was allowed at 100% of the normal depreciation instead of at 50%. These seriouus lapses accounted for an under-charge of tax of Rs. 1.71 lakhs. The Committee are unable to understand how, when the Income-tax Rules are abundantly clear, the assessee company could claim extra shift allowance of more than 100% or normal allowance and how the ITOs could allow such claims. The facts are such as to indicate that the mistakes are not *bonafide*. The matter requires thorough investigation by the Board and the Committee trust that strict disciplinary action will be taken thereafter.
37	3.74	-do-	The Committee find that review conducted by the Department revealed similar lapses in as many as 4 other assessments relating to one of the companies. A review of all company assessments made by the ITOs concerned is called for. And if it shows that similar mistakes have been committed in other cases also, the matter should be referred to the CBI for further investigation.
38	4.8	-do-	According to the Audit paragraph two companies derived income from the manufacture of (a) resins and fabrication of water-treatment equipment and (b) radio-receivers respectively. These

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			were treated as priority industries, even though the relevant schedule in the Act did not mention them. According to Audit such treatment was irregular and resulted in short-levy of tax to the extent of Rs. 3.10 lakhs. The Committee, however, find that as regards (a) although the Audit objection was initially accepted on the opinion given by the Ministry of Industrial Development, the issue had been re-examined. Accordingly it is felt that profits derived by the company from manufacture of the mechanical portion of the water treatment plant is entitled to tax concessions applicable to priority industries but the profits from the manufacture of resin is not entitled to such concession and that the matter has been referred to Audit. As regards (b) although the Department of Electronics had earlier advised the Board that radio-receivers are to be classified as 'telecommunication equipment', they had later mentioned that communication equipments are becoming increasingly electronic in nature. In the meanwhile, the lapses pointed out by Audit had been rectified and the assessees had gone in appeal. The Committee would await the outcome of the appeals.
39	4.9	Finance Rev. & Ins.	The Committee regret the delay in ascertaining the correct position in regard to these cases. They desire that such question should be examined very expeditiously with a view to the officers in the field being apprised of the correct position at the earliest possible date. This was emphasised earlier in paragraph 2.171 of the 87th

			Report (Fifth Lok Sabha), which, it seems, has not been given enough attention to. After ascertaining the correct position in the cases in question, it is also necessary to undertake a general review to see whether assessments involving such industries were properly made.
40	4.20	-do-	Arising out of this case is the general question how the Income-tax Department can find out the quantum of cash assistance and duty drawbacks paid to the exporters with a view to ensuring that the payments received did not escape taxation. The scheme of cash assistance as an export incentive was introduced from 6-6-1966. The grant of duty drawback was in vogue even earlier. It is surprising that it was only after three years that the Board issued instructions on 13-6-1969 indicating how the information relating to cash assistance should be obtained for utilisation in the income-tax assessments and what is worse is no procedure has so far been laid down in regard to duty drawbacks. The Committee would like to have an explanation why this question was not taken up by the Board earlier and what action was taken against the officers concerned for the lapse. The procedure for getting information in regard to the duty drawbacks must be laid down without further delay. If this instance were typical, it is obvious that the tax collection machinery is in no way geared to function efficiently.
41	5.63	-do-	The Audit paragraph brings out a case where under an agreement with a foreign company to purchase 'know-how' considerable income is remitted in foreign currency without subjecting the

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			income to appropriate tax under the Income-tax Act. Under the agreement the foreign company's Indian tax liability was to be borne by the Indian company. The agreement provided for payment of a total of 3.2 million Canadian dollars for the supply of know-how. Although several payments were made, no tax had been deducted at source. A payment of 5 lakh dollars was made in 1961 and another payment of 8 lakhs dollars was made in 1963. In the assessment years 1962-63 and 1964-65, it was claimed that the payments were not subject to income-tax in India as these were received by the foreign company abroad. The assessment for 1962-63 is still pending, which would involve undercharge of tax/ interest to the extent of Rs. 29.17 lakhs if the claim is accepted. For the assessment year 1964-65, only 60% of the income was treated as taxable and it was charged to tax @ 50% as royalty instead of as business income @65%. Further, the income was not grossed up for purposes of tax. All these involved short-levy of tax/ interest to the extent of Rs. 22.42 lakhs which is a substantial amount.
42	5.64	Finance Rev. & Ins.	It was held that the delivery of know-how took place partly outside India and partly in India and accordingly the income was apportioned for the purpose of taxation. The Committee find that there was no provision in the agreement executed in 1961 about the place of delivery of know-how. There was, however, some discus-

sion between the representatives of the Indian and foreign companies on 13th June, 1964 regarding the place of delivery. The Committee do not consider that the minutes of the meeting could be regarded as modification of the original agreement.

43 5.65 -do-

The agreement did not describe the amount received by the foreign company as royalty. As the payment is for 'know-how' which is the subject-matter of business agreement between the two companies, it can only be regarded as business income and not royalty.

44 5.66 -do-

Strangely enough, after protracted consultations between the Ministry of Finance and the Ministry of Law it has been finally held that the payment is for technical know-how, that the technical know-how represented by 6 sets of processing standards only had been delivered from abroad and that no part of the payment could be apportioned as relating to the operations carried out in India. It is inconceivable that the transfer of know-how is limited to the delivery of merely 6 sets of proceessing standards for which the country had to pay through its nose. The payment received by the foreign company has to be viewed in the context of the agreement as a whole. There is admittedly a business connection in terms of Section 9 of the Act and the income has, therefore, to be essentially considered as income deemed to accrue or arise in India. The Committee find that the point has also been examined in a recent decision of the Madras High Court in Commissioner of Income-tax Madras *Vs.*

(1)	(2)	(3)	(4)
			Carborundum Company (92 ITR 411). The Committee were told that it is proposed to examine the matter again in consultation with the Ministry of Law associating the Audit representative. The Committee would urge that this should be done immediately. The Committee further desire that it should also be examined as to what should be the income that should be brought to tax when an agreement stipulates that a certain amount is to be paid net of tax, if that is really permissible.
45	5.67	Finance Rev. & Ins.	The Committee would like to know the action taken to revise the relevant assessments of the company and collect the appropriate revenue in the light of the above. They suggest that the Board's instructions of 17th April, 1969 should also be suitably modified.
46	5.68	-do-	The total amount of royalty payment assessed to tax upto the assessment year 1971-72 in respect of Indian companies having collaboration agreements with foreign companies was Rs. 19.23 crores whereas the total amount of know-how fees was only Rs. 3.24 crores. As know-how fees attract a higher rate of tax (65 per cent) it is necessary to lay down clear guidelines as to how the payments should be identified as relating to royalties or know-how. In this connection the Committee find that the word 'know-how' has not been defined as such in the Income-tax laws or rules. The Committee, therefore, stress that the opinion of the Attorney General

47	5.89	-do
48	5.87	-do-

should be obtained and suitable instructions issued to the assessing officers forthwith for guidance.

The Committee regret to find that at present it is not being ensured that the Central Board of Direct Taxes are consulted at the stage when collaboration agreements involving tax matters are approved. The Government should explain and examine how such a serious lacuna has been allowed to continue for so long. The Committee are not at all satisfied with the extent of scrutiny conducted by the Ministry of Finance in regard to the agreements entered into under the advice and with the approval of the various administrative Ministries particularly by the public sector undertakings. They accordingly emphasise that the Ministry should work out a fool-proof arrangement so that our limited resources are not frittered away in the way, it appears, has happened in the above mentioned cases.

A ruling given by the Ministry in May 1973 in regard to the tax liability of a foreign company under a collaboration agreement with an Indian company in which the Government of India have 51 per cent of shares and L.I.C. 23 per cent of shares came to the notice of the Committee. The facts narrated by the Committee in the foregoing paragraphs would indicate how the Ministry went out of the way on the suggestion of the Ministry of Law and sought modification in the terms of the agreement if certain payments to be made to the foreign company for socalled know-how were to be exempted from tax. The Finance Secretary clearly agreed with the view that

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			the advice should not be in a specific instance. According to him if the basic premise is accepted that the tax determination in a particular case has to be made by the ITO in a quasi-judicial proceeding, then only would the Board express a view in general terms. The matter therefore requires thorough inquiry in depth so as to set out clearly the scope of advice which may be given by the Ministry of Finance (Foreign Tax Division) in such matters.
49	5.88	Finance (Rev. & Ins.)	Incidentally, the Committee find that the collaboration agreement had already been finalised in November, 1972 incorporating the relevant terms as originally proposed by the undertaking. The determination of tax liability is stated to be pending. The Committee would like to know the final deciesion, if any, taken in the matter keeping in view the above observations as well as in the earlier case concerning collaboration agreement of Hindustan Steel with a foreign company.
50	5.89	-do	The question of the Board's giving advance ruling had been raised before the various committees and commissions which inquired into direct tax administration. In this connection the Committee would refer to paragraph 6.179 of Direct Taxes Enquiry Committee's final report (December, 1971). It appears that unless the Board is authorised by law to give advance rulings the Board should not give advance ruling. The Committee, therefore, desire that in order to

			place the matter on a legal footing necessary amendment to the law should be considered early.
51	5.90	-do-	At present the advance ruling in regard to foreign collaboration agreement seems to be given by the Foreign Tax Division of the Ministry of Finance. As this Division is not a part of the Board, it would appear that it may not be competent to give advance rulings even if the Board is authorised by law. This aspect also requires examination.
52	5.91	-do-	The advice (not ruling) should be not for avoidance or for finding loopholes but it should be in the nature of a general analysis of law as it stands and no more. The Board should not have powers to render regular consultancy service.
53	5.97	-do-	In Audit's view the dividend accrued in respect of vacant chits subscribed to by the company engaged in chit fund business are to be treated as income for the purpose of income-tax assessment of chit fuds as it is not notional but real income. The Committee have been informed by the Ministry that the point raised by Audit would be studied in greater detail and suitable instructions issued, if necessary, in consultation with the Ministry of Law. It is well-known that in the past few years many chit funds companies have sprung up in almost all the States in the country. The number of such entities in the Union Territory of Delhi alone was 121 at the end of 1972. It is, therefore, necessary that the Central Board of Direct Taxes should complete their study of the accounting of these chit funds very ex-

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			peditiously and issue instructions for proper computation of income of the funds so that the levy of income-tax is made uniformly and in the best interests of Government. The working of the chit funds should also be studied in depth because there is good reason to suspect that not all of them keep away from mal-practices which go against the interests of those who invest their funds in them.
54	67	Finance (Rev. & Ins.)	In his case neither the assessee filed voluntarily a sur-tax return nor the Income-tax Officer called for it and no action was taken to assess the company for two years till Audit pointed it out. The explanation for this lapse on the part of the ITO is admittedly unsatisfactory. The Committee had already pointed out in paragraph 6.7 of their 88th Report (Fifth Lok Sabha) that the ITOs had tended to give sur-tax assessments a low priority. They had also stressed that sur-tax assessments should be taken up alongwith the connected assessments of income-tax of the companies. Government should ensure that this recommendation is implemented in letter and spirit.
55	68	-do-	Another unsatisfactory feature of this case is that the ITO did not initiate penalty proceedings against the assessee for his failure to file the sur-tax return until as late as 16th March, 1972. The Committee cannot but deprecate such laxities. They trust that the Board will issue strict instructions to the assessing officers in this regard. They would await a report regarding the number of cases wherein

			the assessees had not filed sur-tax returns voluntarily, the number of cases where penal proceedings were not iitiated and the present position of each of these cases.
56	7.15	-do-	According to Audit the concessional rate of tax for inter-corporate divided is not admissible to the insurance companies. The computation of insurance business income is government by special provisions of the Income-ta Act, 1961. The provisions of the Act relating to the computation of income chargeable under heads "interest on securities", "income from other sources" etc. shall not apply to the computation of profits on insurance. The Ministry are of the view that for the purpose of concessional rate it is or necessary that the dividend received by he company should be chargeable under the head "income from other sources". The Committee nnd that even though Section 80(M) does not deal directly with computation of income "under other sources" it deals with deduction in respect of certain iter-corporate dividends from gross total income. The rules in the First Schedule are quite comprehensive and where it is intended to give a specific deduction, such deduction is mentioned notwithstanding that the same deduction is separately provided for in the general computation sections. It appears that in he absence of a specific provision in he First Schedule itself, the inter-corporate deduction was not intended to be permitted. However, as the matter is not free from doubt, the Committee desire that a competent legal opinion should be obtained in view of considerable tax effect involved.

MGIPND—LS II—533 LS—5-7-74—1,550.